Supreme Court, U.S.
FILED
AUG 31 2005
OFFICE OF THE CLERK

No. 05-295

IN THE

# Supreme Court of the United States

METROMEDIA ENERGY, INC.,

*Petitioner,*

v.

ENSERCH ENERGY SERVICES, INC.; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP; TXU JOHN DOES,

*Respondents.*

**ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

## PETITION FOR WRIT OF CERTIORARI

G. Eric Brunstad, Jr.
*Counsel of Record*
Susan Kim
Brian R. Hole
BINGHAM MCCUTCHEN LLP
One State Street
Hartford, CT 06103
(860) 240-2717

*Counsel for Petitioner*

## QUESTION PRESENTED

Should the Court grant certiorari to resolve a conflict of authority among the courts of appeals over the standard of review applicable to an arbitration award where a party claims that the arbitration panel exceeded its authority by straying beyond the scope of the parties' arbitration agreement and their submission of the issues for arbitration?

## RULE 29.6 STATEMENT AND THE PARTIES TO THE PROCEEDING

Petitioner is Metromedia Energy, Inc. The petitioner has no parent company. No public company owns 10 percent or more of the stock of the petitioner. Respondents are Enserch Energy Services, Inc., TXU Energy Company LLC, TXU Energy Trading, TXU Energy Services, N/K/A TXU Energy Retail Company, LP, and TXU John Does.

## TABLE OF CONTENTS

*Page*

QUESTION PRESENTED ..... i

RULE 29.6 STATEMENT AND THE PARTIES TO THE PROCEEDING ..... ii

TABLE OF CONTENTS ..... iii

TABLE OF AUTHORITIES ..... v

OPINIONS BELOW ..... 1

JURISDICTION ..... 1

RELEVANT STATUTORY PROVISIONS ..... 1

STATEMENT ..... 2

A. The Master Agreement and MME's Natural Gas Orders from TXU ..... 2

B. The Arbitration Proceedings ..... 3

C. The Governing Law ..... 5

D. Proceedings in the District Court and the Third Circuit ..... 8

REASONS FOR GRANTING THE WRIT ..... 10

I. The Courts of Appeals Are Intractably Divided Over the Question Presented and Review in this Court Is Necessary and Warranted to Resolve the Conflict ..... 12

II. The Decision of the Court Below Conflicts with Prior Decisions of this Court ..... 18

III. The Conflict Among the Courts of Appeals Is Untenable, Given the Importance of the Question Presented, and this Case Presents an Ideal Vehicle to Resolve the Conflict ..... 21

IV. Certiorari is Warranted Because the Decision of the Court Below Is Wrong on the Merits ..... 23

CONCLUSION ..... 23

## TABLE OF AUTHORITIES

### FEDERAL CASES

*187 Concourse Associates v. Fishman*, 399 F.3d 524 (2d Cir. 2005) ..... 6, 13

*AT&T Technologies, Inc. v. Communications Workers of Am*, 475 U.S. 643 (1986) ..... *passim*

*American Postal Workers v. Runyon*, 185 F.3d 832 (7th Cir. 1999) ..... 6, 15

*Atkinson v. Sinclair Refining Co.*, 370 U.S. 238 (1962) ..... 18

*Bakery, Confectionary & Tobacco Workers Local Union Number 362-T v. Brown & Williamson Tobacco Corp.*, 971 F.2d 652 (11th Cir. 1992) ..... 14

*Boston & Maine Corp. v. Brotherhood of Maint. of Way Employees*, 94 F.3d 15 (1st Cir. 1996) ..... 16

*Carpenters 46 N. Cal. Counties Conf. Bd. v. ZCON Builders*, 96 F.3d 410 (9th Cir. 1996) ..... 18

*Champion Int'l Corp. v. United Paperworkers Int'l Union*, 168 F.3d 725 (4th Cir. 1999) ..... 17

*Champion Int'l Corp. v. United Paperworkers Int'l Union*, 779 F.2d 328 (6th Cir. 1985) ..... 15

*Coady v. Ashcraft & Gerel*, 223 F.3d 1 (1st Cir. 2000) ..... 17

*Delta Queen Steamboat Co. v. District 2 Marine Engineers Beneficial Ass'n*, 889 F.2d 599 (5th Cir. 1989) ..... 14

*Devine v. Levin*, 739 F.2d 1567 (Fed. Cir. 1984) ..... 14

*Dorado Beach Hotel Corp. v. Union De Trabajadores De La Industria Gastronomica de Puerto Rico*, 959 F.2d 2 (1st Cir. 1992) ..... 6

*Dow Corning Corp. v. Safety Nat'l Casualty Corp.*, 335 F.3d 742 (8th Cir. 2003) ..... 17

*E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279 (2002) ..... 21

*E.I. DuPont de Nemours & Co. v. Local 900*, 968 F.2d 456 (5th Cir. 1992) ..... 14

*E.I. DuPont de Nemours & Co. v. Martinsville Nylon Employees Council Corp.*, No. 94-2222, 1996 U.S. App. LEXIS 3208 (4th Cir. 1996) ..... 17

*Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314 (5th Cir. 1994) ..... 13

*First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) ..... *passim*

*Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362 (Fed. Cir. 2001) ..... 15

*Gateway Coal Co. v. Mine Workers*, 414 U.S. 368 (1974) ..... 5

*GM Corp. v. Pamela Equities Corp.*, 146 F.3d 242 (5th Cir. 1998) ..... 13

*Howsam v. Dean Witter Reynolds*, 537 U.S. 79 (2002) ..... 5, 19

*International Assoc. of Machinists & Aerospace Workers v. Tennessee Valley Auth.*, 155 F.3d 767 (6th Cir. 1998) ..... 15

*Iron Workers Local No. 272 v. Bowen*, 624 F.2d 1255 (5th Cir. 1980) ..... 14

*JLM Indus., Inc. v. Knight-Nielsen SA*, 387 F.3d 163 (2d Cir. 2004) ..... 13

*John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48 (2d Cir. 2001) ..... 14

*John Morrell & Co. v. Local Union*, 913 F.2d 544 (8th Cir. 1990) ..... 6, 17

*John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964) ..... 18

*Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503 (3d Cir. 1994) ..... 16

*KenAmerican Res., Inc. v. International Union of United Mine Workers of Am.*, 99 F.3d 1161 (D.C. Cir. 1996) ..... 17

*Local Union No. 898 v. XL Elec., Inc.*, 380 F.3d 868 (5th Cir. 2004) ..... 13

*Madison Hotel v. Hotel & Rest. Employees, Local 25*, 144 F.3d 855 (D.C. Cir. 1998) ..... 16

*Matteson v. Ryder Sys. Inc.*, 99 F.3d 108 (3d Cir. 1996) .... 9, 15

*Metromedia Energy, Inc. v. Enserch Energy Services, Inc.*, 409 F.3d 574 (3d Cir. 2005) ..... *passim*

*Microchip Technology, Inc. v. U.S. Philips Corp.*, 367 F.3d 1350 (Fed. Cir. 2004) ..... 15

*Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299 (3d Cir. 1982) ..... 6, 15

*Monee Nursery & Landscaping Co., v. International Union of Operating Engineers*, 348 F.3d 671 (7th Cir. 2003) ..... 15

*Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1 (1983) ..... 19

*Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283 (9th Cir. 1988) ..... 17

*PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996) ..... 14

*Refinery Employees Union v. Continental Oil Co.*, 268 F.2d 447 (5th Cir. 1959) ..... 14

*Richmond, Fredericksburg & Potomac RR. Co. v. Transportation Communications Int'l Union*, 973 F.2d 276 (4th Cir. 1992) ..... 16

*Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287 (3d Cir. 2001) ..... 9, 15

*Sarhank Group v. Oracle Corp.*, 404 F.3d 657 (2d Cir. 2005) ..... 13

*Smith v. Currency Trading Int'l Inc.*, No. 98-1311, 1999 U.S. App. LEXIS 18182 (10th Cir. 1999) ..... 13

*Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. 2002) ..... 14

*Steelworkers v. American Mfg. Co.*, 363 U.S. 564 (1960) ..... 19

*Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960) ..... 19

*Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960) ..... 5, 19

*Volt Info. Sciences v. Board of Trustees*, 489 U.S. 468 (1989) ..... 21

*Volvo GM Heavy Truck Corp. v. International Union*, 914 F.2d 1493 (4th Cir. 1990) ..... 16

## FEDERAL STATUTES

9 U.S.C. § 10(a) ..... *passim*

9 U.S.C. § 11(b) ..... *passim*

28 U.S.C. § 1254(1) ..... 1

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit, Pet. App. 1a, is published at 409 F.3d 574. The opinion of the United States District Court for the District of New Jersey, Pet. App. 21a, is unpublished. The opinion of the arbitration panel is reprinted at Pet. App. 30a.

## JURISDICTION

The court of appeals entered its judgment on June 2, 2005. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

## RELEVANT STATUTORY PROVISIONS

Section 10(a) of the Federal Arbitration Act, 9 U.S.C. § 10(a), provides, in relevant part:

> In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of a party to the arbitration . . . [w]here the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

Section 11(b) of the Federal Arbitration Act, 9 U.S.C. § 11(b), provides, in relevant part:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration . . . [w]here the arbitrators have awarded upon a matter not submitted to them . . . .

## STATEMENT

This matter arises out of an arbitration proceeding conducted under the Federal Arbitration Act ("FAA"). Petitioner is Metromedia Energy, Inc. ("MME"), a retail supplier of natural gas. Respondents are Enserch Energy Services, Inc., TXU Energy Company LLC, TXU Energy Trading, TXU Energy Services, n/k/a/ TXU Energy Retail Company, LP, and various TXU John Does (collectively, "TXU"). TXU is also a retail supplier of natural gas.

### A. The Master Agreement and MME's Natural Gas Orders from TXU

In October 1998, MME entered into a contract with TXU (the "Master Agreement") for the supply of natural gas. Under the terms of the Master Agreement, TXU agreed to sell natural gas to MME at TXU's cost plus twenty-five percent of MME's gross profit. The Master Agreement contains an arbitration clause stipulating, in relevant part:

> [A]ny disagreement, difference, or dispute among the Parties ***arising under this Agreement*** shall be resolved pursuant to arbitration according to the procedures set forth in this Article XIV.

Master Agreement, Art. XIV, § 14.1, Pet. App. 42a (emphasis added). The Master Agreement further provides, in relevant part:

> The arbitrator shall settle all disputes in accordance with the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association, to the extent that such rules do not conflict with the terms of such Act or the provisions of this Agreement.

*Id.*, § 14.2, Pet. App. 43a.

MME ordered natural gas deliveries from TXU in two ways: (1) by written instructions, and (2) by telephonic "spot" orders. Between November of 2000 and February of 2001, MME placed numerous telephonic spot orders with TXU, and TXU sent invoices to MME for these orders.

In addition to purchasing natural gas from TXU, MME also sold natural gas to TXU. MME became concerned that TXU was overcharging MME for its deliveries of gas when MME discovered that during one period it had sold gas to TXU at $15 per decatherm unit, while at the same time TXU had sold gas to MME at $23 per decatherm unit. As a result, MME requested information from TXU regarding its pricing. When MME's request went unsatisfied, MME commenced an arbitration proceeding to discover TXU's costs and to determine whether TXU had overcharged MME in violation of the Master Agreement, which, as noted, called for pricing based upon TXU's cost plus a percentage of MME's gross profit.

**B. The Arbitration Proceedings**

In its pre-arbitration filings, MME submitted the following issues: (1) whether TXU had failed to permit MME to inspect TXU's books and records to determine whether TXU had overcharged MME in violation of the Master Agreement; (2) whether TXU had improperly drawn on a letter of credit securing MME's obligations to TXU; and (3) whether TXU had overcharged MME for telephonic spot orders between November 2000 and February 2001. Pet. App. 44a-45a. In response, TXU submitted the following issues: (1) whether MME breached the Master Agreement by failing to share gross profits with TXU; (2) whether MME failed to provide information to permit TXU to determine MME's gross profits; and (3) whether MME failed to pay certain amounts that it owed to TXU. Pet. App. 47a. Just prior to the arbitration hearing, MME and TXU settled and withdrew all of TXU's issues, and settled and withdrew the first two of MME's issues, leaving only MME's third issue of

whether TXU overcharged MME in violation of the Master Agreement. Pet. App. 48a.

A panel of three arbitrators held hearings on the dispute over a period of three days in September 2002. Thereafter, the parties submitted post-hearing briefs. MME argued that the evidence demonstrated that TXU had overcharged MME in violation of the Master Agreement. TXU denied that it had overcharged MME under the terms of the agreement, and argued in the alternative that the telephonic spot transactions did not fall under the Master Agreement at all, but, rather, fell under the terms of a "separate contract" between the parties arising as a "course of performance" entirely independent of the Master Agreement. Pet. App. 49a-50a. TXU never argued that this "separate contract" contained an arbitration provision, or otherwise required arbitration between the parties of any dispute arising under its terms.

On March 3, 2003, the arbitration panel issued its opinion in favor of TXU, expressly concluding that the Master Agreement did not apply to the controversy. The panel specifically determined that MME and TXU had "reached no agreement as to the price to be charged for [the telephonic spot orders] during the months of November 2000 through February 2001." Pet. App. 31a. The panel further concluded that the Master Agreement "does not govern the purchase price for [the telephonic spot orders of natural gas] sold to MME." Pet. App. 32a. Critically, although the arbitrators concluded that the Master Agreement did not apply to the controversy (and, *a fortiori*, that the arbitration clause in the Master Agreement did not apply because the clause applies only to disputes "arising under" the agreement), the arbitrators did not stop there. Instead, they proceeded to determine that TXU's charges for the gas delivered pursuant to the telephonic spot orders under the separate "course of performance" contract were "reasonable," even though this was not one of the issues submitted. Pet. App. 34a. As noted, following the parties' settlement of most of their issues just prior to the arbitration hearing, the only issue

submitted to the arbitrators was whether TXU had overcharged MME in violation of the Master Agreement. The arbitrators further concluded that TXU was the prevailing party in the arbitration, and ordered MME to pay a portion of TXU's costs and attorneys' fees. Pet. App. 36a.

In issuing their opinion, the arbitrators did not expressly analyze the scope of their authority, and they made no findings regarding the scope of the parties' submissions. Further, neither party submitted to the arbitrators the question of the arbitrators' authority to define their jurisdiction.

## C. The Governing Law

This Court has explained that "'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *AT&T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648 (1986) (quoting *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)). This rule "recognizes the fact that arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." *AT&T*, 475 U.S. at 648-49 (citing *Gateway Coal Co. v. Mine Workers*, 414 U.S. 368, 374 (1974)).

This Court has further explained that the question whether the parties have agreed to submit a particular matter for arbitration (i.e., the question of the "arbitrability" of the dispute) is for the court to decide. *See AT&T*, 475 U.S. at 649 ("Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties have agreed to arbitrate is to be decided by the court, not the arbitrator."); *see also Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 84 (2002) ("[A] disagreement about whether an arbitration clause in a concededly binding contract applies to a particular type of controversy is for the court."). In addition, the Court has stated that, in conducting its review of any question of arbitrability, "the court should

decide that question just as it would decide any other question that the parties did not submit to arbitration, namely, independently." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995). Moreover, the Court has directed that, after the district court has conducted its review of the arbitrability of an issue, the court of appeals should review the district court's decision in the same manner that it would consider "any other district court decision finding an agreement between the parties, e.g., accepting findings of fact that are not 'clearly erroneous' but deciding questions of law *de novo*." *Id.* at 947-48.

Under the FAA, parties typically define arbitrability (i.e., the scope of the arbitrator's authority to resolve any particular issue) in two ways: (1) through the terms of their pre-negotiated contractual arbitration clause, and (2) through the terms of their submission of the issues for arbitration. *See, e.g., 187 Concourse Associates v. Fishman*, 399 F.3d 524, 527 (2d Cir. 2005) ("[T]he scope of authority of arbitrators generally depends on the intention of the parties to an arbitration, and is determined by the agreement or submission") (internal quotation marks and citation omitted); *American Postal Workers v. Runyon*, 185 F.3d 832, 835 (7th Cir. 1999) ("The parties may limit the arbitrator's contractual authority to address a dispute through: (1) the contract; and (2) the issue submitted to the arbitrator."); *Dorado Beach Hotel Corp. v. Union De Trabajadores De La Industria Gastronomica de Puerto Rico*, 959 F.2d 2, 4 (1st Cir. 1992) ("[A]n arbitrator's authority [under the parties' contract] may be supplemented by the parties' submissions."); *John Morrell & Co. v. Local Union*, 913 F.2d 544, 561 (8th Cir. 1990) ("[W]e must look both to their contract and to the submission of the issue to the arbitrator to determine his authority.") (emphasis, internal quotation marks, and citation omitted); *Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir. 1982) ("[O]nce the parties have gone beyond their promise to arbitrate and have supplemented the agreement by defining the issue to be submitted to an arbitrator, courts must look both to the contract and the submission to determine his authority")

(citation omitted). Thus, even though a pre-negotiated contract may provide for the arbitration of certain issues, the parties may refine the scope of the arbitration proceeding by agreeing to submit a particular set of issues for resolution through arbitration. Under the express provisions of sections 10(a) and 11(b) of the FAA, a federal district court is authorized to ensure that an arbitrator stays within the bounds of his or her authority by vacating or modifying an arbitration award "[w]here the arbitrators exceeded their powers" or "[w]here the arbitrators have awarded upon a matter not submitted to them." 9 U.S.C. §§ 10(a) & 11(b).

Of course, the parties may agree that the arbitrator, rather than a court, may have the authority to decide the arbitrability of a particular issue under the parties' contract and submissions. But this Court has cautioned that this authority may not be presumed, and must rest upon "clear and unmistakable evidence" that the parties intended the arbitrator to decide arbitrability. *First Options*, 514 U.S. at 944 ("Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and unmistakabl[e]' evidence that they did so.") (quoting *AT&T*, 475 U.S. at 649). Under this standard, "merely arguing the arbitrability issue to an arbitrator does not indicate a clear willingness to arbitrate that issue, i.e., a willingness to be effectively bound by the arbitrator's decision on that point." *Id.* at 946. In this case, the parties did not argue or submit the issue of arbitrability to the arbitrators, and there is no evidence, let alone "clear and unmistakable" evidence, that MME agreed that the arbitrators would decide the arbitrability of the issues addressed in their award. Accordingly, this question is not implicated in this case. What is in dispute is whether the Third Circuit applied the correct standard of review in determining that the arbitrators did not exceed their authority in issuing their award.

## D. Proceedings in the District Court and the Third Circuit

Following the arbitrators' issuance of their opinion, MME commenced a proceeding in the district court to vacate the arbitrators' award on the ground that the award exceeded the arbitrators' authority. The district court agreed, concluding that, "[h]aving found that the Master Agreement [containing the arbitration clause] did not apply to the [telephonic spot] sales, the arbitration panel had no authority to resolve the issues regarding the [independent] contract absent evidence that the parties submitted the issue of the reasonableness of the pricing under the [independent] contract to arbitration." Pet. App. 26a-27a. Conducting its own independent review, the district court expressly found that "the record in this matter does not support TXU's contention that MME and TXU submitted to the arbitrators issues regarding the terms of the [independent] contract and whether TXU's pricing pursuant to the [independent] contract was reasonable." Pet. App. 27a. The district court added: "After reviewing the record, the Court is satisfied that at no time did MME consent to have the panel determine what terms and conditions were applicable to the [independent] contract if the Master Agreement did not apply to the [telephonic spot] sales." *Id.* The district court then vacated the arbitration award "to the extent that it purports to determine the terms of the [independent] contract and . . . to the extent that it purports to determine the propriety of TXU's charges for [telephonic spot] sales from November 2000 to February 2001." Pet. App. 29a. The district court likewise vacated the award of attorneys' fees. *Id.*

TXU appealed the district court's decision to the Third Circuit. Rejecting the district court's standard of review, the Third Circuit reversed. Pet. App. 3a. The Third Circuit began by observing that it owed no deference to the district court's analysis. Further, the court concluded that the district court had erred because it failed to afford the arbitrators' award a heightened degree of deference.

In its brief to the Third Circuit, MME cited this Court's decision in *First Options* and stated that the applicable standard of review that a court of appeals employs in considering a district court's decision regarding the arbitrability of an issue is as follows: "[F]indings of fact are reviewed under the clearly erroneous standard, while questions of law are reviewed *de novo*." Appellee's Brief at 16, *Metromedia Energy, Inc. v. Enserch Energy Services*, 409 F.3d 574 (3d Cir. 2005) (No. 04-1944) ("MME Br."). The Third Circuit, however, applied a different standard, stating that "we owe no deference to the District Court's analysis, and instead we exercise plenary review over the District Court's decision to vacate the arbitration award." Pet. App. 9a.

In its brief to the Third Circuit, MME also cited this Court's decisions in *AT&T* and other cases, and argued that "[a]rbitration is a matter of contract and a party cannot be forced to arbitrate any dispute that it has not agreed by contract to submit." MME Br. at 25-26. MME argued further that the issue of arbitrability is for the court to decide, as the district court did in conducting its independent review in this case. MME Br. at 16. The Third Circuit plainly recognized that "MME's challenge to the arbitration award focuses not upon the underlying merits of the panel's analysis, but rather upon whether the panel exceeded its authority by resolving in its opinion an issue the parties had not agreed to arbitrate." Pet. App. 8a. The Third Circuit, however, rejected the district court's independent review. Adhering to its prior decisions in *Matteson v. Ryder Sys. Inc.*, 99 F.3d 108 (3d Cir. 1996), and *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287 (3d Cir. 2001), the court concluded:

> [T]he arbitrators have the authority in the first instance to interpret the scope of the parties' submissions in order to identify the issues that the parties intended to arbitrate. When confronted with an allegation that the arbitrators exceeded their authority by resolving an issue the parties did not intend to submit, we will review the arbitrator's

> interpretation of the parties' intentions under a 'highly deferential' standard.

Pet. App. 10a.

As noted, the arbitrators never expressly construed their authority under the Master Agreement or the parties' submissions in their written opinion. Accordingly, the Third Circuit lacked any formal, written analysis from the arbitrators to inform application of the court's "highly deferential" standard. Under the Third Circuit's approach, however, this did not matter because "a reviewing court should presume that an arbitrator acted within the scope of his or her authority" and that "this presumption may not be rebutted by an ambiguity in a written opinion." Pet. App. 14a. The Third Circuit then determined that, because TXU and the arbitrators could have believed that the arbitrators had the necessary authority, and "in light of the highly deferential standard of review that we must apply in assessing MME's challenge to the arbitration panel's interpretation of the scope of the parties' submissions, we believe the District Court erred in determining that the arbitration panel lacked the authority to address the reasonableness of TXU's [telephonic spot sales] prices." Pet. App. 18a.

## REASONS FOR GRANTING THE WRIT

The courts of appeals are intractably divided over the proper standard of review to apply in considering whether, in issuing an arbitration award, the arbitrator exceeded his or her authority based upon the parties' contractual agreement and arbitration submissions. This disagreement involves *all* of the courts of appeals. Because the conflict among the courts of appeals is widespread, longstanding, and entrenched, and is unlikely to resolve itself absent intervention by this Court, certiorari review is warranted.

In addition, the decision of the court below conflicts with relevant decisions of this Court. In *First Options*, the Court directed that, at least with respect to an arbitrator's authority to decide an issue under the parties' pre-negotiated contractual agreement, the reviewing court is to conduct an *independent* review. *Id.* at 943. The court below, however, eschewed independence in favor of a highly deferential standard. Furthermore, although this Court has not specifically addressed the standard of review applicable in reviewing an arbitrator's authority based upon the parties' submission of the issues in preparation for the arbitration hearing, there is no reason why the standard should be any different. Both are facets of the same arbitrability question and both define the jurisdiction of the arbitrators. The principles articulated in *First Options* and other relevant decisions of this Court thus apply, and the decision of the court below conflicts with them.

The question presented is important because it implicates the ability of the parties to fashion and rely on their arbitration agreements and submissions. If parties cannot rely on their agreements and submissions, then arbitration will be discouraged. This case likewise presents an ideal vehicle for resolution of the conflict because the question is presented squarely and is outcome-determinative. Conducting an independent review, the district court concluded that the arbitrators exceeded their authority because they resolved issues beyond the scope of the arbitration clause in the Master Agreement and the parties' submissions. Applying a heightened standard of deference to the arbitrators' decision, the Third Circuit reached the opposite conclusion. The Third Circuit did not rule that the district court misapplied the standard of review that it employed, but, rather, that the district court should have applied a standard of heightened deference. The outcome of this case turns on the proper standard of review.

Finally, the decision of the Third Circuit is plainly in error. The correct standard of review is the standard that this Court adopted in *First Options*. Moreover, the Third Circuit's standard

fails to afford due regard to the command of the FAA, which expressly provides that it is for the court, not the arbitrator, to determine questions of arbitrability.

## I. The Courts of Appeals Are Intractably Divided Over the Question Presented and Review in this Court Is Necessary and Warranted to Resolve the Conflict.

The decision below deepens an existing conflict among the courts of appeals over an issue on which all of the circuits have spoken. Moreover, the conflict involves more than a two-way split among the circuits, as the internal precedents *within* five of the circuits also stand in profound disarray. The broad division of authority among and within the courts of appeals demonstrates that certiorari is warranted.

Disputes regarding arbitrability typically arise in two contexts: (1) pre-arbitration (e.g., on a motion to compel arbitration before arbitration has actually begun); or (2) post-arbitration (e.g., in a proceeding to review an arbitral award where one party argues that it never agreed to arbitrate the particular dispute that the arbitrator decided). In the second context (which is the context *sub judice*), the courts of appeals are deeply divided over the appropriate standard of review. Further, the split of authority has two facets. First, courts disagree on the deference to be afforded an arbitrator's decision in the face of a claim that the decision exceeded the scope of the parties' pre-negotiated contractual agreement. Second, courts disagree on the deference to be afforded an arbitrator's decision in the face of a claim that the decision exceeded the scope of the parties' submission of the issues in preparation for the arbitration hearing. In general, courts agree that the standard of review should be same in both situations, but disagree on what that standard should be.

The Second, Fifth, Tenth, and Eleventh Circuits apply a *de novo* standard that recognizes that the question of arbitrability – i.e., whether the arbitrator is authorized to resolve a particular

issue under the parties' contract or submissions – is for the court to decide without deference to the arbitrator. *See Sarhank Group v. Oracle Corp.*, 404 F.3d 657, 661-62 (2d Cir. 2005) (holding that, because "arbitrability is not arbitrable in the absence of the parties' agreement, the district court was required to determine whether [the parties] had agreed to arbitrate," and that "the district court was not, as a matter of law, bound by the arbitrators' determination of arbitrability"); *187 Concourse Associates*, 399 F.3d at 526-27 (reviewing district court's "findings of fact for clear error and questions of law *de novo*" and affirming district court's vacatur of arbitration award on the basis that the arbitrator exceeded his authority because the "arbitrator's authority was limited by both the [parties contract] and the questions submitted by the parties for arbitration"); *JLM Indus., Inc. v. Stolt-Nielsen SA*, 387 F.3d 163, 169, 171 (2d Cir. 2004) (applying "*de novo*" standard and stating that "a disagreement about whether an arbitration clause . . . applies to a particular type of controversy is for the court") (internal quotation marks and citation omitted); *Local Union No. 898 v. XL Elec., Inc.*, 380 F.3d 868, 870 (5th Cir. 2004) (affirming district court's refusal to enforce arbitration award; stating that, in reviewing district court's determination regarding arbitrability, "we accept findings of fact that are not 'clearly erroneous' but review questions of law *de novo*," and that, "[a]s the district court noted, the question of arbitrability is a question for the court"); *Smith v. Currency Trading Int'l, Inc.*, No. 98-1311, 1999 U.S. App. LEXIS 18182, *5 (10th Cir. 1999) (affirming district court's decision to vacate an arbitration award because "the question of arbitrability was subject to independent review by the courts") (internal quotation marks and citation omitted); *GM Corp. v. Pamela Equities Corp.*, 146 F.3d 242, 248 (5th Cir. 1998) ("[C]ourts should not assume or conclude that the parties agreed to submit the question of the scope of the arbitrator's own authority to that arbitrator unless there is 'clear and unmistakable evidence' that they did so"); *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1321 (5th Cir. 1994) ("We begin by noting that the question of whether a party can be compelled to arbitrate, as well as the question of what issues a

party can be compelled to arbitrate, is an issue for the court rather than the arbitrator to decide."); *Bakery, Confectionary & Tobacco Workers Local Union Number 362-T v. Brown & Williamson Tobacco Corp.*, 971 F.2d 652, 655 (11th Cir. 1992) ("Although the arbitrator is confined to deciding issues properly before him, it is the court's task to determine what issues were originally submitted to the arbitrator."); *E.I. DuPont de Nemours & Co. v. Local 900*, 968 F.2d 456, 458 (5th Cir. 1992) ("Courts are free . . . 'to scrutinize the award to ensure that the arbitrator acted in conformity with the jurisdictional prerequisites of the [parties' agreement].'") (quoting *Delta Queen Steamboat Co. v. District 2 Marine Engineers Beneficial Ass'n*, 889 F.2d 599, 602 (5th Cir. 1989)); *Iron Workers Local No. 272 v. Bowen*, 624 F.2d 1255, 1264 (5th Cir. 1980) ("[D]etermining just what issues were submitted to an arbitrator is a task for the court") (citing *Refinery Employees Union v. Continental Oil Co.*, 268 F.2d 447, 451 (5th Cir. 1959) *cert denied*, 361 U.S. 896 (1959)); *see also Specht v. Netscape Communications Corp.*, 306 F.3d 17, 26-27 (2d Cir. 2002) (applying *de novo* standard and stating that, "[u]nless the parties clearly provide otherwise, the question of arbitrability – whether an . . . agreement creates a duty for the parties to arbitrate the particular grievance – is undeniably an issue for judicial determination") (internal quotation marks and citations omitted); *John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48, 53, 57-58 (2d Cir. 2001) ("Issues of 'arbitrability' are presumptively for the court to decide") (internal quotation marks and citation omitted); *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193, 1198 (2d Cir. 1996) ("Where the arbitration agreement contains an ambiguity as to *who* determines eligibility, the [FAA's] presumption favoring arbitration is reversed so that the court will ordinarily decide the question.") (emphasis in original); *cf. Devine v. Levin*, 739 F.2d 1567, 1570 (Fed. Cir. 1984) (noting that the question of arbitrability is for the court to decide).[1]

---

[1] In administering the FAA in cases within its jurisdiction, the Federal

In contrast, the Third, Sixth, and Seventh Circuits give great deference to an arbitrator's decision regarding arbitrability. *See Metromedia Energy, Inc v. Enserch Energy Services, Inc*, 409 F.3d 574, 578-80 (3d Cir. 2005) (Pet. App. 1a) ("In determining the appropriate standard of review of the arbitrator's interpretation of the scope of the submission, we indicated that 'there is no doubt that our review of the interpretation of a submission is highly deferential.'") (quoting and citing *Matteson v. Ryder Sys., Inc.*, 99 F.3d 108, 113 (3d Cir. 1996); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 301 (3d Cir. 2001)); *Monee Nursery & Landscaping Co. v. International Union of Operating Engineers*, 348 F.3d 671, 676 (7th Cir. 2003) (recognizing that "an arbitrator's authority is [] limited by the actual issue submitted by the parties," but holding that "[t]he arbitrator's interpretation of the scope of the issue must be upheld so long as it is rationally derived from the parties' submission") (citing *American Postal Workers Union v. Runyon*, 185 F.3d 832, 835 (7th Cir. 1999)); *International Assoc. of Machinists & Aerospace Workers v. Tennessee Valley Auth.*, 155 F.3d 767, 772 (6th Cir. 1998) ("'The extraordinary deference given to an arbitrator's ultimate decision on the merits applies equally to an arbitrator's threshold decision that the parties have indeed submitted a particular issue for arbitration.'") (quoting *Champion Int'l Corp. v. United Paperworkers Int'l Union*, 779 F.2d 328, 335 (6th Cir. 1985)); *Mobil Oil Corp.*, 679 F.2d at 302 ("[W]e believe that the deference that is accorded to an arbitrator's interpretation of the [parties contract] should also be

---

Circuit is "obligated to follow regional circuit law on questions of arbitrability that are not 'intimately involved in the substance of enforcement of a patent right.'" *Microchip Tech. Inc. v. U.S. Philips Corp.*, 367 F.3d 1350, 1356 (Fed. Cir. 2004) (quoting *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1365 (Fed. Cir. 2001)). In *Flex-Foot* (a patent case) the court stated: "When reviewing district court decisions upholding arbitration awards, we accept findings of fact that are not clearly erroneous and decide questions of law *de novo*." 238 F.3d at 1365 (citing *First Options*, 514 U.S. at 948).

accorded to an arbitrator's interpretation of the issue submitted").[2]

In further contrast, decisions *within* the First, Fourth, Eighth, Ninth, and District of Columbia Circuits stand in confusing disarray. In some cases in which arbitrability is in dispute, these courts have applied a highly deferential standard of review. *See Madison Hotel v. Hotel & Rest. Employees, Local 25*, 144 F.3d 855, 857 (D.C. Cir. 1998) ("An arbitrator's view of the issues submitted to him for arbitration therefore receives the same judicial deference as an arbitrator's interpretation of [the parties' contract]."); *Boston & Maine Corp. v. Brotherhood of Maint. of Way Employees*, 94 F.3d 15, 19 (1st Cir. 1996) ("[A]n arbitrator's view of the scope of the issue committed to his or her care is entitled to the same far-reaching respect and deference as is normally accorded to the arbitrator's interpretation of the [parties' contract] itself."); *Richmond, Fredericksburg & Potomac RR. Co. v. Transportation Communications Int'l Union*, 973 F.2d 276, 280 (4th Cir. 1992) ("The arbitrator's interpretation of the scope of the issues is entitled to deference . . . and must be upheld so long as it is rationally derived from the parties' submission.") (citations and quotations omitted); *Volvo GM Heavy Truck Corp. v. International Union*, 914 F.2d 1493 (4th Cir. 1990) ("[T]he

---

[2] It should be noted that the Third Circuit has not been entirely consistent in its approach. *See Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503, 1512 (3d Cir. 1994) ("An arbitrator's decision to assert jurisdiction over objection is, however, subject to a much broader and more rigorous juridical review than an arbitral decision on the merits. Because it is 'a question for the court to decide,' it is subject to *de novo* judicial review.") (quotation marks and citation omitted), *aff'd, First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995). Nevertheless, the more recent decisions in the Third Circuit, including the decision below, have, as noted, applied a highly deferential standard.

reviewing court must defer to an arbitrator's interpretation of the contours of the issues submitted") (internal quotation marks and citations omitted); *John Morrell & Co.*, 913 F.2d at 560 ("[A]n arbitrator's interpretation of the scope of the issue submitted to him is entitled to the same deference accorded his interpretation of the [parties' contract]"); *Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 285 (9th Cir. 1989) ("We now hold that an arbitrator's interpretation of the scope of the issue submitted to him is entitled to the same deference accorded his interpretation of the [parties' contract].").

In other cases addressing the same issue, however, the very same courts have insisted that no deference be paid to the arbitrators' decision regarding arbitrability. *See Dow Corning Corp. v. Safety Nat'l Corp.*, 335 F.3d 742, 747 (8th Cir. 2003) (holding that the arbitrators exceeded their authority by deciding an issue that goes to the scope of their authority); *Coady v. Ashcraft & Gerel*, 223 F.3d 1, 9 (1st Cir. 2000) (reversing the district court's reliance on the view that it must defer to the arbitrator's decision regarding the scope of the submission; stating that, where the parties did not agree in their contract that the question of arbitrability was for the arbitrator to decide, "the arbitrators' views about what is arbitrable are not given the usual leeway courts give to arbitrators"; concluding that the arbitrators' views on the scope of their authority "carries no weight and is not entitled to deference"); *Champion Int'l Corp. v. United Paperworkers Int'l Union*, 168 F.3d 725, 728 (4th Cir. 1999) (observing that question of arbitrability is for the court to decide); *KenAmerican Res., Inc. v. International Union of United Mine Workers of Am.*, 99 F.3d 1161, 1163 (D.C. Cir. 1996) (stating that "[i]t is now settled that a federal court must decide *de novo* whether the parties agreed to arbitrate a particular dispute, unless the parties unmistakably indicate that arbitrability issues are to be decided by an arbitrator," and that, in resolving disputes over arbitrability "we may not afford any deference at all to the arbitrator's view on that issue"); *E.I. DuPont de Nemours & Co. v. Martinsville Nylon Employees Council Corp.*, No. 94-2222, 1996 U.S. App. LEXIS 3208, *6 (4th Cir. 1996)

("[W]e decide whether DuPont was required to submit the dispute . . . to arbitration without deferring to the decision of the arbitrator."); *Carpenters 46 N. Cal. Counties Conf. Bd. v. ZCON Builders*, 96 F.3d 410, 415 (9th Cir. 1996) ("[T]he district court erred in deferring to the arbitrator's decision" regarding arbitrability).

The Court should resolve this clear, protracted, and longstanding conflict among and within the courts of appeals. Unless this Court intervenes, the conflict is not likely to resolve itself, and permitting the conflict to continue is not likely to provide additional insight on how the question should be decided, given that all of the circuits (and innumerable lower courts) have examined the question with such divergent results.

## II. The Decision of the Court Below Conflicts with Prior Decisions of this Court.

In this case, the Third Circuit has decided an important federal question in a way that conflicts with relevant decisions of this Court. Although the specific contexts of this Court's relevant precedents differ in some respects from the context of the instant case, the reasoning of the court below clearly conflicts with the governing principles that this Court has previously articulated in addressing the proper standard of review that a federal court should apply in addressing questions of arbitrability.

This Court has explained that, "'[u]nder our decisions, whether or not the company was bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the Court on the basis of the contract entered into by the parties.'" *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 546-47 (1964) (quoting *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 241 (1962)). Likewise, the Court has explained that the relevant principles underlying this conclusion "are not new," but were established long ago "in a series of cases known as the *Steelworkers Trilogy*." *AT&T*, 475 U.S. at 648 (citing

*Steelworkers v. American Mfg. Co.*, 363 U.S. 564 (1960); *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960)).

As the Court stated in *AT&T*, "[t]he first principle gleaned from the *Trilogy* is that 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *AT&T*, 475 U.S. at 648 (quoting *Warrior & Gulf Navigation Co.*, 363 U.S. at 582)). Further, "[t]he second rule, which follows inexorably from the first, is that the question of arbitrability . . . is undeniably an issue for judicial determination." *AT&T*, 475 U.S. at 649. Thus, "[a]lthough the Court has also long recognized and enforced a 'liberal federal policy favoring arbitration agreements,' . . . it has made clear that there is an exception to this policy: The question whether the parties have submitted a particular dispute to arbitration, i.e., the '*question of arbitrability*,' is 'an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.'" *Howsam*, 537 U.S. at 83 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *AT&T*, 475 U.S. at 649; *First Options*, 514 U.S. at 944).

Where the parties have agreed in unmistakably clear terms that the arbitrator may resolve the arbitrability of a particular dispute, a court reviewing the arbitrator's decision "should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances." *First Options*, 514 U.S. at 943. On the other hand, where "the parties did *not* agree to submit the arbitrability question itself to arbitration, then the court should decide [the arbitrability] question just as it would decide any other question, namely, independently." *Id.* "After all," the Court continued, "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, . . . but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms, . . . and according to the

intentions of the parties." *Id.* at 947 (internal quotation marks and citations omitted).

In *First Options*, the Court likewise framed the relevant choice of review standards in the following way. On the one hand, "the Court of Appeals said that courts should *independently* decide whether an arbitration panel has jurisdiction over the merits of any particular dispute." *Id.* at 941 (internal quotation marks and citation omitted) (emphasis in original). On the other hand, "[Petitioner] asked us to decide whether this is so (i.e., whether courts, in reviewing the arbitrators' decision on arbitrability, should apply a *de novo* standard of review or the more deferential standard applied to arbitrators' decisions on the merits). . . ." *Id.* (internal quotation marks and citations omitted). On the merits, the Court clearly selected the former. *Id.* at 944-47.

The decision of the court below, adopting a "highly deferential" standard of review, plainly conflicts with this Court's analysis in *First Options*. Factually, *First Options* involved the question whether a person who had *not* executed a contract containing an arbitration clause could be bound by an arbitration award obtained *within* the scope of the authority otherwise conferred by the contract. In contrast, this case involves the question whether a party that *has* executed a contract containing an arbitration clause may be bound by an award conducted *outside* the scope of the authority conferred by the contract and the parties' submissions. Notwithstanding these factual differences, however, there is no principled reason why the relevant rules applicable to each should not be the same.

Either arbitrability is for a court to decide, or it is not. This Court has directed repeatedly that the question of arbitrability *is* for the court to decide, and affording great deference to arbitrators on the question of arbitrability is the antithesis of the Court's direction. Moreover, just as there is no reason to defer to an arbitrator's decision when a person cannot be bound by an award because he was not bound by the contract

under which the award was obtained, there is no reason to defer to an arbitrator's decision when a person cannot be bound by an award because the award exceeds the arbitrator's authority. If the parties wish to surrender their right to independent judicial review, they may do so by agreement, stating in clear and unmistakable terms that the arbitrator is to determine arbitrability. Where they have not do so, there is simply no basis to conclude that a court may surrender a party's right to independent judicial review of the question of arbitrability through application of a highly deferential standard of review.

## III. The Conflict Among the Courts of Appeals Is Untenable, Given the Importance of the Question Presented, and this Case Presents an Ideal Vehicle to Resolve the Conflict.

The purpose of the FAA is to facilitate arbitration by promoting the use of contractual arbitration agreements. *See E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002); *Volt Info. Sciences v. Board of Trustees*, 489 U.S. 468, 479 (1989). In support of its goals, the FAA protects the integrity of the arbitration process by authorizing federal courts to ensure that arbitral proceedings and awards do not exceed the bounds of the arbitral authority conferred by the parties' agreement and submissions. *See* 9 U.S.C. §§ 10(a) & 11(b). If parties cannot be certain that the jurisdictional limits conferred by their agreements and submissions will be respected and enforced, they will be discouraged from entering into such agreements. Judicial review is thus important to ensure that the essential goals of the FAA are achieved.

In this case, the "highly deferential" standard endorsed by the court below, as well as by other courts of appeals, effectively erodes this essential certainty. Applying its highly deferential standard, the court below essentially concluded that the arbitration award would stand so long as the arbitrators might have believed that they had the necessary authority to make it, regardless of whether they actually had the necessary authority.

This approach effectively strips the parties of their right to define contractually the scope of an arbitration proceeding at the expense of the integrity of the proceedings themselves.

Because certainty of outcome is a key consideration in the crafting of any contract, the issue is one of great importance in the design and administration of arbitration agreements and proceedings. By the same token, the uncertainty generated by the conflict among the courts of appeals is correspondingly untenable, particularly in the five circuits that have internally inconsistent precedents. This is especially true for negotiated commercial arbitration agreements of the kind at issue in this case. Here, the parties expressly limited the scope of their arbitration clause in accordance with its specific terms, and they likewise expressly bargained for application of the FAA. Sections 10(a) and 11(b) of the FAA clearly reserve for the court the question of determining the arbitrability of issues, whether pursuant to the parties contract or through their submissions. The decision of the Third Circuit, like the decisions of other courts of appeals that apply a deferential standard, is unsettling precisely because it failed to honor the parties' agreement and the provisions of the FAA. This Court should intervene to correct the Third Circuit's error and remove the uncertainty created by the conflict among the courts of appeals.

This case presents an ideal vehicle to resolve the conflict because the question is presented squarely and is outcome-determinative. In this instance, the district court conducted an independent review of the arbitrators' award, concluding that the award must be vacated. In contrast, the court of appeals applied a standard of great deference, concluding that the award must stand. There is no suggestion that the district court applied its "independent review" standard incorrectly, only that, in the view of the court of appeals, it applied an incorrect standard. The selection of the appropriate standard is thus dispositive.

## IV. Certiorari Is Warranted Because the Decision of the Court Below Is Wrong on the Merits.

Finally, for the reasons explained above, the decision of the court below is plainly in error and must be reversed. Based upon the principles that this Court has articulated and enforced repeatedly over a long series of decisions, the standard of review embraced by the court below is fundamentally flawed. The decision of the court below likewise stands at odds with the directives of sections 10(a) and 11(b) of the FAA, which prescribe that the question of arbitrability is for the court to decide. At the same time, the Third Circuit's decision is hardly an aberration. Rather, as indicated above, it adheres to prior circuit precedent and embraces the same erroneous standard of review that other courts of appeals have adopted and enforced over a long period of time. Accordingly, this Court should intervene to correct an error that otherwise will persist.

## CONCLUSION

For the foregoing reasons, the Court should grant the petition.

Respectfully submitted,

G. Eric Brunstad, Jr.
*Counsel of Record*
Susan Kim
Brian R. Hole
BINGHAM MCCUTCHEN LLP
One State Street
Hartford, CT 06103
(860) 240-2717

*Counsel for Petitioner*

Dated: August 31, 2005

# APPENDIX

**APPENDIX A — OPINION OF THE COURT IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED JUNE 2, 2005**

**IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

Case No: 04-1944

METROMEDIA ENERGY, INC.

v.

ENSERCH ENERGY SERVICES, INC.; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP; TXU JOHN DOES TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP,

Defendants/Third-Party Plaintiffs

v.

METROMEDIA COMPANY,

Third-Party Defendant

ENSERCH ENERGY SERVICES, INC; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP,

Appellants

*Appendix A*

Argued March 29, 2005

OPINION OF THE COURT

SMITH, *Circuit Judge*.

In this case, we are called upon to review an arbitration award arising out of a dispute between TXU Energy Retail, LP ("TXU") and Metromedia Energy Services, Inc. ("MME") concerning a series of natural gas sales by TXU to MME. The March 3, 2003 arbitration award found that TXU had not overcharged MME for sales of natural gas that took place between November 2000 and February 2001. On April 10, 2003, MME responded to the arbitration award by filing suit against TXU in the District Court for the District of New Jersey. MME sought to vacate the award on the ground that the arbitration panel had exceeded its authority by addressing the reasonableness of TXU's prices for the disputed natural gas sales, after having first found that these sales were not subject to the pricing structure set forth in a 1998 Master Agreement between TXU and MME.

The District Court granted summary judgment in favor of MME, holding that the arbitration panel had exceeded its authority by addressing the reasonableness of the prices charged by TXU for sales not governed by the 1998 Master Agreement. The District Court also vacated the arbitration panel's award of attorneys fees, finding that the panel's decision concerning attorney fees "was necessarily based on the panel's inappropriate decision" concerning the reasonableness of TXU's prices. TXU appeals, arguing that the District Court's decision does not reflect the deference

due the arbitration panel's award under the Federal Arbitration Act ("FAA"), 9 U.S.C. § § 1-16. We agree, and accordingly will reverse the judgment of the District Court and remand with instructions to enter judgment in favor of TXU.

## I. FACTUAL BACKGROUND

MME is a natural gas retailer that sells natural gas to end users in the northeastern United States. In October 1998, MME entered into a Master Agreement with appellant TXU, another natural gas retailer that undertook to obtain natural gas through a wholesale trading affiliate for delivery to MME. Under this Master Agreement, MME agreed to purchase gas from TXU pursuant to written confirmations that would specify the term, volume, and price for particular purchases. For a period of approximately two years after the signing of the Master Agreement, MME made purchases under the Agreement using written confirmations. MME also, on various occasions, made purchases of additional quantities of gas, the terms of which were negotiated by telephone with TXU representatives. These telephone transactions related to what the parties refer to as "spot-market" purchases. Spot-market transactions were transactions wherein a specified volume of gas would be ordered by MME for a one-month period only, and the price per dekatherm of such gas would not be provided by TXU until after the gas had been delivered. It also appears from the record that the telephonic spot-market transactions between the parties typically involved shorter lead times between order and delivery when compared to the purchases made by MME from TXU pursuant to the written confirmation process set forth in the Master Agreement.

*Appendix A*

Article XIV of the Master Agreement contained an arbitration provision indicating that "any disagreement, difference or dispute among the Parties arising under this Agreement shall be resolved pursuant to arbitration according to the procedures set forth in this Article XIV." This arbitration clause called for each party to select one arbitrator, with the two initial arbitrators thus selected jointly selecting a third. The arbitration provision further provided that "[t]he arbitrator shall settle all disputes in accordance with the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association, to the extent that such rules do not conflict with the terms of such Act or the provisions of this Agreement."

In October 2001, MME initiated arbitration proceedings against TXU pursuant to the arbitration clause contained in the Master Agreement. MME claimed that TXU had breached the Master Agreement by overcharging MME for various purchases of natural gas between November 2000 and February 2001. MME's initial statement of claims indicated that the telephonic spot-market purchases referenced above were among the purchases for which MME had allegedly been overcharged. In setting forth its cause of action for breach of contract, MME's statement of claims alleged that "TXU has further violated the Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases." (The parties refer to the period between November 2000 and February 2001 as the "Disputed Period").

*Appendix A*

TXU responded to MME's claims by arguing that spot-market transactions between the two parties were not governed by the pricing provisions contained in Section 7.1 of the Master Agreement. Instead, TXU argued (in its Second Amended Response) that either (a) the prices for spot-market purchases were established under a separate course-of-dealing contract between TXU and MME; or (b) the course of dealing between TXU and MME had operated to modify the pricing provisions of the Master Agreement insofar as spot-market purchases were concerned.

The parties proceeded to arbitration, which resulted in a March 3, 2003 award in favor of TXU. The arbitration panel found that the spot-market purchases were not governed by the Master Agreement, and were instead subject to a separate "course of performance" contract. The latter arose from the parties' actual dealings, in which, according to the arbitration panel, TXU had charged prices that reasonably reflected market conditions at the time of each spot-market purchase by MME. The arbitration panel also awarded TXU one-third of its attorneys' fees, finding that TXU was the "prevailing party" in the arbitration and thus was the "non-defaulting party" under the attorney fee provision contained in the Master Agreement.

MME responded to the arbitration award by filing suit in District Court. MME sought to vacate the arbitration award on the ground that the arbitration panel, once having determined that spot-market purchases during the Disputed Period were governed by a separate course-of-performance contract, had exceeded its authority by also stating that TXU's prices under that contract were reasonable and accurately

reflective of prevailing market conditions. The District Court agreed, holding that the arbitration panel had exceeded its authority by determining the reasonableness of TXU's prices under the course-of-performance contract. The District Court also vacated the arbitration panel's award of attorneys' fees, finding that the panel's decision concerning attorney fees "was necessarily based on the panel's inappropriate decision that TXU's charges were reasonable under [the] spot gas contract...."

## II. ANALYSIS

The District Court exercised diversity jurisdiction over MME's suit pursuant to 28 U.S.C. § 1332. We exercise appellate jurisdiction over the District Court's final order pursuant to 28 U.S.C. § 1291.

This appeal centers on the question of whether the arbitration panel exceeded the scope of its authority by stating in its written award decision that TXU's sales of spot-market gas to MME during the Disputed Period "were consistently priced and properly reflected market price on the dates volumes were requested and delivered." MME argued before the District Court that once the arbitration panel determined that TXU's spot-market sales were not governed by the pricing provision contained in the Master Agreement, the panel lacked authority to decide whether TXU's prices under a separate course-of-performance contract were reasonable and fairly reflected market conditions. MME based its argument on the fact that the Master Agreement's arbitration clause covers "any disagreement, difference or dispute among the Parties *arising under this Agreement* [.]" (Emphasis

added). MME argued that since the parties had agreed only to arbitrate disputes arising under the Master Agreement, the arbitration panel's finding that spot gas transactions during the Disputed Period *were not* governed by the Master Agreement deprived the panel of the authority to address the reasonableness of TXU's prices under an implied course-of-performance contract that lacked an arbitration clause. The District Court agreed with MME, holding that once the arbitration panel had determined that TXU's spot-market sales to MME were not subject to the Master Agreement, the panel's inquiry should have ceased. The District Court reasoned that the issue of whether TXU had or had not breached a separate course-of-performance contract was not a dispute arising under the Master Agreement, and thus was not subject to arbitration.

On appeal, TXU argues that the arbitration panel's award reflects a legitimate exercise of the panel's authority. TXU maintains that the submissions made by the parties during arbitration, taken as a whole, provided a reasonable basis for the arbitration panel to conclude that it was empowered to incorporate into award its findings concerning the reasonableness of TXU's spot-market prices in connection with sales to MME during the Disputed Period. TXU also argues that the District Court's decision fails to reflect the substantial deference owed by a federal court to an arbitration panel's award pursuant to the FAA.

Review of arbitration awards under the FAA is "extremely deferential." *Dluhos v. Strasberg*, 321 F.3d 365, 370 (3d Cir.2003). Vacatur is appropriate only in "exceedingly narrow" circumstances, such as where

arbitrators are partial or corrupt, or where an arbitration panel manifestly disregards, rather than merely erroneously interprets, the law. *See id.; Local 863 Int'l Bhd. of Teamsters v. Jersey Coast Egg Producers, Inc.*, 773 F.2d 530, 533 (3d Cir.1985) (stating that error of law is insufficient basis for vacatur). Likewise, an arbitrator's " 'improvident, even silly, factfinding' does not provide a basis for a reviewing court to refuse to enforce the award." *See Major League Umpires Assoc. v. American League of Professional Baseball Clubs*, 357 F.3d 272, 279-80 (3d Cir.2004) (quoting *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509, 121 S.Ct. 1724, 149 L.Ed.2d 740 (2001)).

Here, MME's challenge to the arbitration award focuses not upon the underlying merits of the panel's analysis, but rather upon whether the panel exceeded its authority by resolving in its opinion an issue the parties had not agreed to arbitrate. The District Court adopted MME's view, predicating its opinion on a provision in the FAA which indicates that an arbitration award may be vacated "if the arbitrators exceed their powers, or so imperfectly execute them that a mutual, final and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4). The concerns raised by MME and the District Court arise from the principle that arbitration is a creature of contract, and an arbitration panel has the authority to decide only the issues that have been submitted for arbitration by the parties. *See Matteson v. Ryder Sys. Inc.*, 99 F.3d 108, 114 (3d Cir.1996).

In *Matteson*, we considered the standard of review applicable where a party seeks to vacate an arbitration award based upon allegations that the arbitrators exceeded the scope

of their authority by purporting to resolve issues the parties had not agreed to arbitrate. We began by explaining that in reviewing a district court decision concerning the validity of an arbitration award, our assessment of the arbitration panel's actions is governed by the same standard that governed the District Court's review. *See Matteson*, 99 F.3d at 112. Thus, we owe no deference to the District Court's analysis, and instead we exercise plenary review over the District Court's decision to vacate the arbitration award.

In relation to our review of the arbitration award itself, we noted that "an arbitrator has the authority to decide only the issues actually submitted" by the parties. *See id.* at 112-13 (citing *United Parcel Serv., Inc. v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, Local Union No. 430*, 55 F.3d 138, 142 (3d Cir.1995)). We then stated that "[i]t is the responsibility of the arbitrator in the first instance to interpret the scope of the parties' submission, but it is within the courts' province to review an arbitrator's interpretation." *Id.* at 113 (citing *Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir.1982)). In determining the appropriate standard for our review of the arbitrator's interpretation of the scope of a submission, we indicated that "there is no doubt that our review of the interpretation of a submission is highly deferential." *Id.* We also rejected the argument that lesser deference should be accorded to an arbitrator's assessment of the scope of his own authority where such an assessment was based upon the arbitrator's factual determinations concerning which issues were actually submitted by the parties. *See id.* at 113 n. 6. However, we cautioned that "[e]ffusively deferential language

notwithstanding, the courts are neither entitled nor encouraged simply to 'rubber stamp' the interpretations and decisions of arbitrators." *Id.* at 113.

We noted in *Matteson* that our efforts to apply this standard of review were hampered by the parties' failure during the course of the arbitration jointly to prepare a single document listing the precise issues they wished to submit to the arbitration panel. *See id.* at 114. Under such circumstances, we held that "absent a formal, written submission, we must look to the parties' conduct as a whole." *Id.* We stated that "[t]o determine the intent of the parties given the circumstances in this case ... we cannot limit ourselves to simply one or a few documents." *Id.* We also stated that we would not focus upon isolated statements within the documents submitted by the parties, but would instead "examine the documents with an eye towards arranging each of them to create a complete picture." *Id.*

To summarize, *Matteson* indicates that the arbitrators have the authority in the first instance to interpret the scope of the parties' submissions in order to identify the issues that the parties intended to arbitrate. When confronted with an allegation that the arbitrators exceeded their authority by resolving an issue the parties did not intend to submit, we will review the arbitrator's interpretation of the parties' intentions under a "highly deferential" standard. Nonetheless, this deference is not a rubber stamp, and our review must focus upon the record as a whole in determining whether the arbitrators manifestly exceeded their authority in interpreting the scope of the parties' submissions.

*Appendix A*

MME argues that the arbitration panel's written opinion in support of the arbitration award reveals that the panel exceeded its authority. Where an allegation that an arbitration panel has exceeded its authority is based upon the language of the written opinion in support of the panel's award, our decision in *Roadway Package System, Inc. v. Kayser,* 257 F.3d 287 (3d Cir.2001), provides additional guidance concerning our inquiry. In *Roadway Package,* after surveying earlier authority addressing such issues, we distilled three basic principles that must guide our review: "(1) a reviewing court should presume that an arbitrator acted within the scope of his or her authority; (2) this presumption may not be rebutted by an ambiguity in a written opinion; but (3) a court may conclude that an arbitrator exceeded his or her authority when it is obvious from the written opinion." 257 F.3d at 301.

With these principles in mind, we turn to MME's challenge to the arbitration panel's award. We must question at the outset the manner in which MME and the District Court have interpreted the panel's written opinion supporting its award. The District Court apparently adopted the view that the arbitration panel had first determined that TXU's spot-market sales to MME during the Disputed Period were governed by a course-of-performance contract, and had then, as a separate inquiry, determined that TXU charged reasonable, market-based prices under this course-of-performance contract. We do not believe the arbitration panel necessarily compartmentalized its analysis in this manner. An alternative reading of the panel's written opinion is that the panel assessed the evidence concerning the prices charged by TXU for spot-gas transactions, found that these prices

accurately reflected market conditions at the time, determined that these market-based prices met the expectations of *both parties* at the time of TXU's spot gas sales to MME, and then held, based on the mutual satisfaction of the parties' contemporaneous expectations, that spot-gas transactions were governed by an implied course-of-performance contract rather than by the pricing structure set forth in the 1998 Master Agreement.

Support for this reading flows from the sequence in which the arbitration panel set forth its factual findings on the second and third pages of its opinion. The panel cited testimony from TXU witnesses indicating that TXU intended all spot-gas sales during the Disputed Period to be "at then-current market prices otherwise available for sale and purchase at the specific delivery points[.]" The panel noted that these same witnesses testified that TXU's calculation of the market price for these transactions was based upon information drawn from the spot-gas market indices contained in the industry publications "*Inside FERC* " and "*Gas Daily.*" The panel also noted that documentation sent by TXU to MME in connection with these transactions indicated that the prices for spot-gas sales were different than the prices for purchases governed by written confirmations executed pursuant to the Master Agreement. The panel's opinion then discusses the testimony of MME witness Lawrence Morris, who apparently testified that "he recognized that the price for spot gas was not commensurate with the confirmed transaction price for each LDC, but that as long as the price was close to the Gas Daily index price for that period, he raised no objection and ultimately paid the price specified." After describing Morris's testimony in

this manner, the arbitration panel's opinion states: "Thus, agreement as to price for spot sales was independent of the Master Purchase Agreement and determined on a month-to-month basis."

When viewed in context, we believe this opening portion of the arbitration panel's written opinion highlights the fact that the panel's findings concerning the market-based nature of TXU's prices were not made as part of an independent inquiry, separate and apart from the finding that a course-of-performance contract rather than the Master Agreement governed TXU's spot-market sales to MME. Instead, these findings were part of the panel's rationale for why it believed a course-of-performance contract existed in the first place. The panel reviewed the evidence in the record, found that TXU had charged market-based prices, found that these market-based prices satisfied MME's expectations, found that MME was aware that these market-based prices differed from the prices that would have arisen under the Master Agreement's pricing provisions, found that MME raised no contemporaneous objection to these prices, and concluded based on these findings that the parties had intended to calculate the price for spot-gas sales on a month-to-month basis, independent of the pricing structure contained in the Master Agreement. In this context, there is no support for the District Court's view that the arbitration panel somehow exceeded its authority by following this chain of reasoning in the course of rejecting MME's breach of contract claim and concluding that TXU had not breached the Master Agreement.

We recognize, of course, that both MME and the District Court may have interpreted the arbitration panel's opinion as having first found that a course-of-performance contract existed, and only then having moved on to address the reasonableness of TXU's prices under this separate contract. This interpretation does not entirely make sense, because it seems more logical to believe that the arbitration panel first made its findings concerning what the parties' course of performance actually was, and then considered whether this course of performance reflected mutually-held expectations such that it could be said to constitute a separate contractual arrangement independent of the Master Agreement. It is not possible for us to say with complete certainty which interpretation most accurately captures the actual intentions of the arbitration panel. However, we find that the interpretation discussed at length above is a reasonable reading of the arbitration panel's written opinion. Given this fact, the District Court was wrong to seize on a contrary reading and to invoke that reading as a basis for concluding that the arbitration panel exceeded its authority. The District Court's approach runs afoul of the core principles identified in *Roadway Package,* which held that "a reviewing court should presume that an arbitrator acted within the scope of his or her authority" and that "this presumption may not be rebutted by an ambiguity in a written opinion." *See Roadway Package System, Inc.*, 257 F.3d at 301.

Moreover, even if we were to adopt the District Court's interpretation of the arbitration panel's written opinion, we would still uphold the panel's award. Here, as in *Matteson,* the parties failed to submit to the arbitrators a single comprehensive document listing the precise issues that the

arbitrators were being asked to resolve. Thus, if we were to assume that the arbitration panel's findings concerning the reasonable, market-based nature of TXU's spot-market prices were not simply part of the panel's rationale for rejecting MME's claim that the Master Agreement applied to spot-market transactions, we would review the record as a whole to determine whether the arbitration panel reasonably believed the parties had submitted to it the issue of whether TXU's spot-market prices reasonably reflected prevailing market conditions. *See Matteson*, 99 F.3d at 114. While our review of such issues cannot be a "rubber stamp," it is clear that we must take a "highly deferential" approach in considering whether an arbitration panel has reasonably interpreted the scope of the parties' submissions. *See id.* at 113.

We believe the record as a whole provided an adequate basis upon which the arbitration panel could conclude that it was empowered to address the reasonableness of TXU's spot-gas prices in the event that a course-of-performance contract rather than the Master Agreement governed the parties' spot-gas transactions. The "Causes of Action" section in MME's initial Statement of Claims alleged that "TXU has further violated the [Master] Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases." This section does not reference Appendix I of the Master Agreement, which defines the "Contract Price" for purposes of sales governed by the Agreement. Thus, both TXU and the arbitration panel may reasonably have believed that MME's overcharge allegations were predicated upon multiple factors depending upon the specific sales in

question. Certainly, it is clear from the record that TXU believed that the issue of whether its spot-gas prices reasonably reflected market conditions was implicated by MME's claims, and thus was before the arbitrators. For example, TXU's pre-arbitration brief described the testimony TXU intended to elicit during the arbitration hearing. Among other things, TXU stated that its testimony would establish that "as is customary in the natural gas industry, TXU Energy often purchased this spot gas on the open market, delivered the gas to MME *and charged MME a market-based price for the gas.*" (Emphasis added). A later subheading near the conclusion of the same brief asserted that "[t]he price charged by TXU Energy for spot gas was both market-based and consistent with the parties' course-of-performance." In support of this assertion, TXU indicated that "testimony will amply show that the price charged by TXU Energy to MME for spot gas during the relevant time period was based on the parties' course-of-performance and was well within the market price ranges published in both *Inside FERC* and *Gas Daily.*"

Consistent with its pre-hearing brief, TXU apparently introduced testimony during the course of the arbitration concerning the extent to which the prices for its spot-market sales to MME were consistent with prevailing market conditions as reflected in the leading industry pricing indices during the Disputed Period. TXU discussed this testimony in its post-hearing briefing, focusing primarily upon testimony provided by one of TXU's expert witnesses, and arguing based on this testimony that "there is almost always a range of reasonableness and not just a single number that can be reasonable," and that the prices for TXU's spot-market

sales to MME fell within this range. TXU's post-hearing brief also discussed documentary evidence in the form of letters sent by MME to various MME customers during 2001, in which MME defended its recent price increases by noting that market prices for natural gas had risen substantially during the prior months. TXU argued that these MME letters established three key facts: "(1) [that] MME, and not just TXU Energy, was justifying its spot gas prices based on the *Gas Daily* index range, which reflects the market; (2) [that] the market had spiked dramatically due to weather; and (3) [that] the $23.00 price was within the market range and therefore reasonable."

Based on the excerpts and testimony discussed above, it appears that TXU believed throughout the arbitration proceedings that MME's claims might implicate the question of whether TXU had charged reasonable, market-based prices for its spot-market sales to MME during the Disputed Period. Notably, at no point during the arbitration proceedings did MME raise the jurisdictional concerns that it now invokes. For example, MME never argued that TXU's repeated references in its opening brief to the market-based nature of its spot-market prices were irrelevant, on the ground that resolving that issue was beyond the scope of the arbitration panel's authority. Nor does MME appear to have objected to the evidence introduced by TXU at the arbitration hearing with respect to the correlation between TXU's spot-market prices and the market-based range of acceptable prices established by the leading industry pricing indices during the Disputed Period. Even when TXU's post-hearing brief made it crystal clear that TXU believed the arbitrators were empowered to address the reasonableness of its spot-market

prices during the Disputed Period, MME chose not to send a letter or seek leave to file a reply challenging TXU's submission of an issue that MME had (supposedly) not agreed to arbitrate.

Thus, at the time the arbitration panel crafted its written opinion in support of its award, it was faced with a record in which one party had repeatedly presented evidence and arguments concerning the reasonableness of its spot-market prices under a course-of-performance contract during the Disputed Period, and the other party had never objected to these arguments on the ground that this issue was beyond the scope of the panel's authority. Accordingly, even if we were to adopt the District Court's interpretation of the arbitration panel's written opinion, we would hold that TXU's briefs and hearing testimony, combined with MME's acquiescence to TXU's presentation of the issue, provided the arbitration panel with a reasonable basis to conclude that it was empowered to address whether TXU's spot-market prices under the course-of-performance contract accurately reflected market conditions at the time of the spot-market sales to MME. Therefore, in light of the highly deferential standard of review that we must apply in assessing MME's challenge to the arbitration panel's interpretation of the scope of the parties' submissions, we believe the District Court erred in determining that the arbitration panel lacked the authority to address the reasonableness of TXU's spot-market prices.

Having found that the arbitration panel did not exceed its authority, we also hold that the District Court erred in vacating the panel's award of attorneys' fees to TXU. The

arbitration panel found that TXU was the "prevailing party" in the arbitration and thus was the "non-defaulting party" under the attorney fee provision contained in the Master Agreement. MME mounts a broad challenge to this fee award, arguing that even if we reverse the District Court's opinion vacating the substance of the arbitration panel's award decision, we nonetheless should affirm the District Court's vacatur of the fee award. MME argues that the arbitration panel's fee award, pursuant to the Master Agreement's attorney fee provision, "is inconsistent with [the panel's] conclusion that the Agreement did not apply to the parties' dispute."

This argument makes little sense. The Master Agreement's fee provision indicated that "[t]he defaulting Party shall pay all reasonable costs and expenses (including attorney's fees) incurred by the non-defaulting party in the enforcement of its rights under this Agreement, whether incurred through legal action or otherwise." MME initiated arbitration against TXU, and asserted largely unsuccessful claims that TXU had breached the Master Agreement. TXU, in response to MME's initiation of arbitration, filed counterclaims against MME, and recovered $1,830,866.19 in settlement of these counterclaims prior to completion of the arbitration proceedings. Based on these facts, the arbitration panel reasoned that because TXU had successfully defeated the bulk of MME's overcharge claims under the Master Agreement, and had recovered a substantial sum in settlement of its counterclaims filed in connection with the arbitration proceedings, TXU was the "non-defaulting party" under the Master Agreement's fee provision, and thus was entitled to recover its reasonable costs and expenses. Contrary

to MME's assertion, the arbitration panel's reliance on the existence of a separate course-of-performance contract, as part of its basis for rejecting MME's overcharge claims under the Master Agreement, is in no way inconsistent with the panel's finding that TXU was the "non-defaulting party" under the Master Agreement's fee provision. Moreover, our review of arbitration awards is "extremely deferential," *see Dluhos,* 321 F.3d at 370, and we must uphold the arbitration panel's award so long as it "draws its essence" from or "arguably construes or applies" the parties' contract, a standard that we are confident is satisfied by the panel's decision here. *See News Am. Pub. v. Newark Typographical Union,* 918 F.2d 21, 24 (3d Cir.1990).

For the foregoing reasons, the decision of the District Court is reversed, and the case is remanded with instructions to enter judgment in favor of TXU.

## APPENDIX B — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY DATED MARCH 1, 2004

**UNITED STATES DISTRICT COURT**
**DISTRICT OF NEW JERSEY**

Hon. Stanley R. Chesler
Civ. A. No. 03-1561(SRC)

METROMEDIA ENERGY, INC.,

Plaintiff,

v.

ENSEARCH ENERGY SERVICES, INC., TXU ENERGY COMPANY LLC, TXU ENERGY TRADING, TXU ENERGY SERVICES, n/k/a TXU ENERGY RETAIL COMPANY, LP, and TXU John Does,

Defendants.

---

TXU ENERGY SERVICES, n/k/a
TXU ENERGY RETAIL COMPANY, LP,

Third-Party Plaintiff,

METROMEDIA COMPANY,

Third-Party Defendant.

*Appendix B*

## OPINION

CHESLER, District Judge

This matter comes before the Court upon the motion by plaintiff and third-party defendant Metromedia Energy, Inc., ("MME") for partial summary judgment vacating the arbitration award in the matter *Metromedia Energy, Inc. v. TXU Energy Trading Co.*, No. 71 Y 198 00887 1 (Mar. 3, 2003), before the American Arbitration Association and defendants TXU Energy Services n/k/a TXU Energy Retail Company, LP, Ensearch Energy Services, Inc., TXU Energy Trading Company LP n/k/a TXU Portfolio Management Company LP, TXU Energy Company LLC, and TXU John Does (collectively, "TXU") motion for summary judgment seeking confirmation of the arbitration award in the proceeding before the American Arbitration Association (the "arbitration). For the reasons set forth below, the Court will grant plaintiff's motion and vacate the arbitration award. Defendants' motion will be denied.

## BACKGROUND

The facts of this case are well-known to the parties and thus the Court will only discuss those facts necessary to decide the pending motions. MME and TXU entered into a Master Gas Sale/Purchase Agreement (the "Master Agreement") on October 8, 1998, that governed the parties "term[1]" gas transactions. In addition to the parties' term sales, MME and TXU entered into certain "spot[2]" gas transactions

1. "Term" sales were those in which the parties agreed in advance to the price of the gas to be purchased.

2. "Spot" sales were those made without prior agreement by the parties and whose price was determined by the current market rate.

that are central to the dispute here. Specifically, MME contends that TXU overcharged it for the "spot" gas TXU sold to MME between November 2000 and February 2001. Believing that the parties' spot gas sales governed were by the Master Agreement, MME exercised its rights pursuant to Section 12.1 of the Agreement to either sue TXU in court or pursue its claims in arbitration.[3]

During the parties' arbitration, MME alleged that because the spot gas sales were subject to the Master Agreement, TXU was obliged to adhere to the pricing provision of the Master Agreement in its spot gas transactions. In other words, MME argued that the spot gas transactions were to be charged according the "Contract Price" as set forth in the Master Agreement.[4]

---

3. Section 12.1 of the Master Agreement provides, in pertinent part, that

> Subject to the provision of Article XIV, upon the occurrence of an Event of Default, the Party which has not committed the Event of Default. . . . will have the right to exercise all rights and remedies available to it under this Agreement . . . including the rights (a) to initiate binding arbitration proceedings . . . to seek damages, [and] (b) to file suit to compel the Party which has committed the Event of Default. . . to perform[.]

4. Appendix ! to the Master Agreement defines "Contract Price" as follows:

> "**Contract Price**" means the price per MMBtu, expressed in U.S. Dollars, for which Gas is sold and

(Cont'd)

Conversely, TXU maintained that the spot gas transactions were not covered by the Master Agreement, and thus were not be charged according to the Contract Price. Indeed, TXU argued that the spot gas sales were not only outside the Master Agreement, but were, in fact, a separate contract formed within the provisions of Article Two of the Uniform Commercial Code ("UCC"). As a result of the second contract governing spot gas sales, TXU considered the pricing provisions of the Master Agreement inapplicable and therefore priced the spot sales in accordance with market prices. TXU further claimed that the prices it charged for the spot sales were reasonable under prevailing market rates.

The Arbitration panel ruled on March 3, 2001, that the Master Agreement did not apply to the spot gas sales, but that the spot gas sales were governed by a separate contract fanned by the parties' course of performance. *See* Arbitration Award at 3. The panel also found that the market prices that TXU charged for the spot gas sales were "within the range of applicable indices" and that there was no evidence that TXU artificially increased prices or 'gouged' the price for

---

(Cont'd)

> purchased pursuant to a Transaction, as specified on the applicable Confirmation. The Contract Price shall be a function of cost plus profit share, Cost, shall generally be set at a NYMEX plus basis at the time the contract between Buyer and the Customer . . . is entered. On a case-by-case basis, Buyer may add an amount . . . based upon Customer credit, market conditions, and other relevant factors. The Gross Profit for each Transaction will be set out on the Transaction Confirmation prepared for the Transaction.

incremental spot sales during this volatile period." *See id.* at 5. The panel further noted that since TXU's position was ultimately vindicated by the arbitration panel, TXU was entitled to "some award for reasonable costs and attorney fees . . . under the contract." *See id.* at 6-7. The panel awarded TXU one-third of its attorneys' fees in connection with the arbitration. *Id.*

**DISCUSSION**

In its motion, MME argues that the arbitration panel had no authority to decide that the prices TXU charged for the spot gas transactions were reasonable. In fact, MME maintains that once the arbitration panel found that a course of performance contract governed the spot gas transactions and not the Master Agreement, the panel lost its authority to hear decide questions under the course of performance contract (the "spot gas contract"). Further, MME asserts that the arbitration award should be vacated *in toto* because TXU had impermissible ex parte communications with a member of the arbitration panel.

It is well-settled that the scope of an arbitrator's authority is "derived either from the agreement between the parties or from the parties submissions to the arbitrators. *Mutual Fire, Marine & Inland Ins. Co. v. NORAD Reinsurance Co., Ltd.*, 868 F.2d 52, 56 (3d Cir. 1989) (citing *Swift Indus. v. Botany Indus.*, 466 F.2d 1125, 1131 (3d Cir. 1972)); *see also United Indus. Workers v. Gov't of the Virgin Islands*, 987 F.2d 162, 168 (3d Cir. 1993) ("An arbitration agreement, however, need not be express, but also may be inferred from the conduct of

the parties."); *Peruvian Connection, Ltd. v. Christian*, 977 F. Supp. 1107, 1111 (D. Kan. 1991) ("Even if a particular dispute is not within the original arbitration agreement between the parties, it is hornbook law that parties by their conduct may agree to send issues outside an arbitration clause to arbitration." (Quotation omitted).

The Federal Arbitration Act ("FAA") provides, however, that a court may vacate an arbitration award if "*the arbitrators exceeded their powers*, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made." 9 U.S.C. §10(a)(4) (emphasis added). Consequently, "[i]t is the responsibility of the arbitrator in the first instance to interpret the scope of the parties' submission, but it is within the courts' province to review an arbitrator's interpretation." *Matteson v. Ryder Sys. Inc.*, 99 F.3d 108, 113 (3d Cir. 1996) (citing *Mobile Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir. 1982)).

Here, the arbitration panel concluded that MME and TXU "reached no agreement as to the price to be charged for incremental/spot gas volumes delivered by TXU to MME . . . during the months of November 2000 through February 2001." *See* Arbitration Award at 1. Accordingly, the panel found that "the Master Purchase Agreement does not govern the purchase price for incremental spot gas sold to MME" and that those sales were governed by a separate spot gas contract. *Id.* at 3. Having found that the Master Agreement did not apply to the spot gas sales, the arbitration panel had no authority to resolve the issues regarding the spot gas contract absent evidence that the parties submitted the issue

of the reasonableness of the pricing under the spot gas contract to arbitration. The Court concludes that the record in this matter does not support TXU's contention that MME and TXU submitted to the arbitrators issues regarding the terms of the spot gas contract and whether TXU's pricing pursuant to the spot gas contract was reasonable.

In particular, the Court notes that the central dispute between the parties in the arbitration was whether the Master Agreement applied to the spot gas sales, and more specifically, whether the pricing Provisions of the Master Agreement applied to the spot gas sales. After reviewing the record, the Court is satisfied that at no time did MME consent to have the panel determine what terms and conditions were applicable to the spot gas contract if the Master Agreement did not apply to the spot gas sales.

Indeed, the record reflects that TXU raised the notion of an oral spot gas contract only as an affirmative defense to MME's claim that the Master Agreement applied to spot gas sales. As MME notes, "[n]o party asked the arbitration panel to make a determination of the terms and conditions of any separate agreement nor did any party ask the panel to determine if the prices charged by TXU were reasonable." Affidavit of Steve Chiscano in Opposition to Defendants' and Counter Plaintiffs' Motion for Summary Judgment at ¶ 6 ("Chiscano Aff. at ¶ __"). In such circumstances, "an [arbitration] award will, of course, be enforceable only to the extent it does not exceed the scope of the parties' submission." *United Parcel Serv., Inc. v. Int'l Brotherhood*

*of Teamsters, Chauffers, Warehousemen and Helpers of Am., Local Union No. 430*, 55 F.3d 138, 142 (3d Cir. 1995).

Having found that the panel's determination in respect of the terms and reasonableness of the pricing under the spot gas contract exceeded the panel's authority and must be vacated, the Court also will vacate the attorneys' fee award granted to TXU. It is clear to the court that the attorneys' fee award was predicated, at least in part, on the panel's conclusion that TXU was a prevailing party in the arbitration and thus permitted a fee award as a "non-defaulting" party under the Master Agreement. *See* Master Agreement at §12.1. Since that finding was necessarily based on the panel's inappropriate decision that TXU's charges were reasonable under spot gas contract, it follows that the attorneys' fee award must be vacated.

Further, MME urges the Court that the entire arbitration award should be vacated based on alleged improper communication between counsel for TXU and its party arbitrator Peyton Feltus after an order by neutral arbitrator Ernest Edwards, Jr. MME's request must be denied.

It is clear that the Court has the power to vacate an arbitration award where the "arbitrators were guilty of . . . any other misbehavior by which the rights of the party have been prejudiced." 9 U.S.C. §10(a)(3). However, the "burden of proof [rests] squarely on the shoulders of the [moving party] to show that prejudicial ex parte communications took place." *NORAD*, 868 F.2d at 57. Here, after reviewing the record, the Court is satisfied that the communications between TXU's counsel and its party arbitrator were not improper.

Indeed, the record reflects that although Mr. Edwards had imposed a ban on ex parte communications, that ban was lifted on January 22, 2003, prior to TXU's communications with Mr. Feltus. *See* Affidavit of Thomas F. Lillard at ¶ 4. Further, the Court perceives no prejudice from TXU's de minimus communications with Mr. Feltus. In short, the Court will not find impropriety in this case sufficient to vacate the panel's award where a party arbitrator who, at the very least, is sympathetic to that party's position, communicates with its party during an arbitration. Additionally, MME has not been able to demonstrate to the Court how it was prejudiced by those contacts. Accordingly, the Court will deny MME's request to vacate the entire arbitration award.

Lastly, as the Court noted during oral argument, the applications by the parties concerning the stipulated settlement of TXU's counterclaims in this case will be denied pending further submissions by the parties.

**CONCLUSION**

For the foregoing reasons, the Court will grant plaintiff's motion to vacate the arbitration award to the extent that it purports to determine the terms of the spot gas contract and the to the extent that its purports to determine the propriety of TXU's charges for spot gas sales from November 2000 to February 2001. The Court further will vacate the attorneys' fee award. Finally, the Court will deny the parties' application to confirm that part of the arbitration award concerning the stipulated settlement of TXU's counterclaims pending further briefing.

s/
Stanley R. Chesler, U.S.D.J.

## APPENDIX C — ARBITRATION AWARD AND FINAL ORDER IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED MAY 1, 2003

BEFORE THE AMERICAN ARBITRATION ASSOCIATION

No. 71 Y 198 00887 1

METROMEDIA ENERGY, INC.

Claimant,

VERSUS

TXU ENERGY TRADING CO.-L.U.

Respondent.

ARBITRATION AWARD AND FINAL ORDER

Article XIV of the Master Gas Sale/Purchase Agreement ("Master Purchase Agreernent") at issue requires that the judgment in the matter be rendered by the Chairman of the Arbitration Panel; however, each of the issues raised by both parties has been thoroughly discussed and debated by the Panel as a whole and this Award represents the unanimous vote of the Panel as well as the ruling of the Chairman with the exception of the Chairman's award of attorney's fees and costs to which Mr. Kasey objects. Based on the pleadings, responses to discovery requests, testimony of fact and expert witnesses, exhibits introduced at the hearing on the merits, pre- and post-trial briefs, and post-hearing information

provided at the request of the Arbitration Panel, it is the opinion of the Arbitration Panel that Metromedia Energy, Inc. ("MME") and TXU Retail Services ("TXU Retail") reached no agreement as to the price to be charged for incremental/spot gas volumes delivered by TXU to MME at various LDC delivery points during the months of November 2000 through February 2001.

MME claims that the Master Purchase Agreement is a full-requirements contract, that the price for all incremental spotgas delivered to MME for resale to various customers behind LDC delivery points/city gates with confirmed transaction prices must be sold at those contirmed prices, and that the price to be charged for incremental gas for "cost plus" customers is TXU Energy Trading Company's ("TXU Trading") net weighted avenge cost of gas after due consideration of hedges, swaps, and other financial transactions which TXU Trading entered to minimize the booked cost of gas for physical delivery to MME.

TXU argues that (a) the Master Purchase Aareement covers only confirmed transactions pursuant to which a specific volume and price for delivery of gas has been agreed to and confirmed by e-mail or written agreement, and (b) the Master Purchase Agreement does not govern the sale of any incremental gas not otherwise covered by a swing option on confirmed transactions for purchases at specific LDC delivery points. Witnesses of TXU testified that all spot sales were to be at then-current market prices otherwise available for sale and purchase at the specific delivery points, but determined generally in accord with either Inside FERC plus basis for those purchases made after the close of bid week but before

close of pipeline nominations for the following month or Gas Daily's daily monthly average for a request for additional intra-month supplies.

A single price was charged for all incremental spot gas deliveries on the monthly invoices to MME irrespective of whether the spot gas was purchased in advance of the month at the close of bid week or requested and priced on a day-to-day basis during the month in question. That average, incremental spot gas price was set out separately for each delivery point and clearly was not the same as prices for that month for any confirmed transaction. Prior to the volumes of incremental spot gas delivered for the months of November 2000 through February 2001, Mr. Lawrence Morris testified that he recognized that the price for spot gas was not commensurate with the confirmed transcation price for each LDC, but that as long as the price was close to the Gas Daily index price for that period, he raised no objection and ultimately paid the price specified. Thus, agreement as to price for spot sales was independent of the Master Purchase Agreement and determined on a month-to-month basis.

In the opinion of the Arbitration Panel, the Master Purchase Agreement does *not* govern the purchase price for incremental spot gas sold to MME above volumes represented by swing options for specific confirmed transactions. The price for incremental spot gas is *not* governed by the current confirmed transaction price, the weighted average cost of gas to TXU Trading, or the definition of "Contract Price" in the Master Purchase Agreement. Moreover, MME is *not* entitled, in determining the price to be paid to TXU Retail, to the benefit of TXU

*Appendix C*

Trading's hedges, swaps, or other financial transactions to protect or to minimize the price for the physical purchase of gas for resale by TXU Trading or for the "transfer price" to TXU Retail.

The term "Contract Price" is predicated upon NYMEX plus basis at the time the contract is entered between MME and its customer. NYMEX pricing is closed at the time that incremental spot gas purchases are made or priced, and NYMEX is inapplicable to spot gas purchases for next-day gas, in any event. Under the Master Purchase Agreement "Contract Price" for confirmed transactions was based upon cost of gas to TXU Retail plus a margin to TXU Retail of the greater of 3¢ or 25% of MME's gross margin on the sales price. However, it would appear that agreement as to the purchase price of even confirmed transactions was never determined in that manner. MME did not inform TXU of its margin, and the price was consistently set without regard to the "Contract Price."

MME shifted a substantial portion of its purchases over time from confirmed transactions to incremental spot purchases. The term "cost" for purposes of incremental spot purchases is based upon fair-market price at the time the request for incremental volumes is made by MME, and TXU's witnesses Messrs, Gibbs and Kralich explained the methodology for reaching the internal transfer price between TXU Trading and TXU Retail. MME accepted that calculation and paid the price so determined until January and February 2001, challenging the price for incremental gas for the months of November 2000-February 2001. Since MME purchased and resold the incremental gas for those months, the question

then becomes whether the price charged on a monthly basis by TXU to MME for incremental spot gas for November through February was resonable in light of the market place during the four months in question. Since the price set out on each monthly invoice for each LDC delivery point is a weighted average cost of spot gas for both gas requested prior to the closing of pipeline nominations and incremental volumes requested on a day-to-day basis or during some periods within a month of delivery, one must look both to whether TXU retail sales prices were within the range of applicable indices and whether the methodology used in those four months was generally consistent with that used in months prior thereto.

The Arbitration Panel finds that the method was consistent with a few exceptions and that the price set was within the range of the applicable indices. No evidence was introduced in support of a cliam that TXU Retail artificially increased prices or "gouged" the price for incremental spot sales during this volatile perior. Accounting errors were made with respect to which index was used as a benchmark for pricing certain limited volumes (i.e. Inside FERC or Gas Daily), which error amounts to an overcharge of $64,255.00. TXU's methodology for pricing in January varied from that used in prior months by 14¢ per dekatherm for 225,106 dekatherms resulting in an overcharge of $31,515.00. One could argue that a few other accounting errors were made, but should have been addressed in the MME audit and joint party stipulation entered just prior to the hearing on, the merits in this matter. Any other such accounting issues are thereby waived.

*Appendix C*

TXU Retail charged an added margin for deliveries to a few customers of MME in December and one in January. TXU argues and testimony supports that such additional charge was not added profit, but a 50¢ charge per dekatherm of incremental gas attributable to fees for additional services requested by MME for daily and monthly balancing, imbalance trading to avoid penalties, and monthly allocations with LDCs. MME disputes whether such services were provided except as to PECO, and Mr. Lawrence Morris testified that, in any event, no agreement was reached as to whether a fee would be charged let alone what the reasonable value thereof should be. The Panel is of the opnion that valuable services were provided at the request of MME, eliminating substantial risk for LDC imbalance penalties. However, the Panel questions the reasonableness of the charge for the service especially when no basis for 50¢ a dekatherm was presented and such services were charged at 5¢ during the same period for CNG South Pool. Our collective experience is that fees of this nature were added soley to incremental gas purchases because balancing was acheived with spot gas; that the volatility of the market at the time in question justified higher fees than 5¢, but that 30¢ per dekatherm and not 50¢ was a more appropriate charge. Moreover, such charges for PSE&G should have been made on TETCO volumes only. Accordingly, $78,737.00 should be credited to the amount owed by MME for November 2000 – February 2001, representing an overcharge to MME for balancing services provided with respect to sales to PECO, PSE&G, E Town, and S Jersey.

With those exceptions, the prices charged for incremental volumes were consistently priced and properly reflected

market price on the dates volumes were requested and delivered.

Accordingly, IT IS ORDERED that,

1. TXU shall, in accordance with the Arbitration Panel's ruling above, credit to MME a total sum of $174,507.00 against the amount stipulated in paragraph 2 as due and owing by MME to TXU Retail.

2. TXU filed a counterclaim in this matter with respect to amounts that remain due and owing by MME for natural gas delivered prior to the termination of the Master Purchase Agreement and billing errors, if any, with respect thereto. TXU and MME reached a settlement and stipulation pursuant to which MME shall payto TXL $2,005,373.19, subject to credit/reduction otherwise due MME as a result of this arbitration. That credit is limited to the amount referenced above in paragraph no. (1) in conjunction with the pricing of sales of incremental spot gas and balancing fees during the months of November 2000 through February 2001. Accordingly; MME shall pay to TXU the amount of $1,830,866.19.

3. The contract provides that the "defaulting Party" *shall* pay all reasonable costs and expenses (including attorney's fees) incurred by the non-defaulting party. Both parties have

sought reimbursement for attorney fees and costs. Who is the defaulting Party'? Most jurisdictions conclude that the prevailing party is the non-defaulting Party. In this instance, the greater award is to TXU Retail, and the crediting of overcharges by the Arbitration Panel does not arise from issues asserted by MME but from accounting errors or other matters raised by the Panel in its audit of TXU Retail's charges. The credits do *not* directly relate to the reasonableness of the price charged for incremental gas volumes. As arbitrator Kasey points out, on the other hand, however, the arbitration was initiated in the first instance to obtain information MME claims TXU would not voluntarily provide and sought a reduction in the amount owed. Accordingly, MME withheld payment; for these reasons, Mr. Kasey objects to the award of attorney fees and costs. In short, neither side has "clean hands" completely, but TXU prevails to the extent that some award for reasonable costs and attorney fees is due under the contract. It is the order of the Chairman pursuant to Articles 12.1 and 14.1. that TXU may recover one-third of attorney's fees paid to Hunton & Williams to defend the arbitration and one-third of costs excluding the fees of its appointed arbitrator. Affidavits of fees and costs shall be submitted to the Chairman, and MME may challenge the reasonableness of any charge.

4. The request of MME for payment of attorney and expert fees, administrative costs, and expenses of the Arbitration is DENIED. The administrative cost of the Arbitration and the fees and expenses of the Chairman of the Arbitration Panel shall be borne equally by Claimant and Respondent, and the fees and expenses of the appointed members of the Arbitration Panel shall be paid by the party appointing that arbitrator.

_____s/_____
ERNEST L. EDWARDS, CHAIRMAN

March 3, 2003

*Appendix C*

BEFORE THE AMERICAN ARBITRATION ASSOCIATION

No. 71 Y 198 00887 1

METROMEDIA ENERGY, INC.

Claimant,

VERSUS

TXU ENERGY TRADING CO.-L.U.

Respondent.

FINAL ORDER

As part of the March 3, 2003, Arbitration Award, TXU Energy Trading Co. ("TXU") was allowed to submit statements of attorneys' fees in the amount of $319,013.52 and costs and expenses in the amount of $82,567.47 of the arbitration (excluding the fees of its appointed arbitrator) incurred in this matter for which they would be reimbursed by Metromedia Energy, Inc. ("MME") for 1/3 of the reasonable attorneys' fees and costs submitted. Affidavits, time records, and cost accounting documentation was received in early April from Hunton & Williams on behalf of TXU, and, as permitted by the Arbitration Award, a Challenge to the Reasonableness of TXU's Attorneys' Fees and Costs was submitted on MME's behalf by Davis, Cedillo

& Mendoza on April 9, 2003, seeking first a ruling that TXU failed to prove that its fees and expenses are reasonable under Texas and New Jersey law, and that TXU's own actions created the need for the arbitration and that thus it should be awarded no attorneys' fees or costs and expenses. In the alternative, MME requests a disallowance of $45,555.25 in attorneys' fees and $5,024.47 in claimed expenses.

After giving due consideration to the arguments and briefs of both parties and to the support for the claim of TXU for reimbursement of 1/3 of its reasonably incured attorneys' fees and reimbursement of costs, IT IS ORDERED that,

1. MME's request that TXU's claim for reimbursement of attorneys' fees and costs to be rejected is hereby DENIED.

2. MME's claim for reduction in TXU's proposed reimbursment of attorneys' fees and costs is GRANTED IN PART and DENIED IN PART, such that TXU is entitled to reimbursment by MME of $99,787.06 for attorneys' fees, and $26,470.82 for costs. The amount must be paid directly by MME or the pevious credit granted to ME by the Arbitration Award adjusted by the total of $126,257.88 if the prior award has not been paid.

*Appendix C*

3. The total fees payable to the Chairman of the Arbitration Panel shall be $49,564.83, which have now been deposited with the American Arbitration Association and paid to the Chairman of this Panel.

_____s/_____
ERNEST L. EDWARDS, CHAIRMAN

May 1, 2003

## APPENDIX D — EXCERPT OF MASTER GAS SALE/ PURCHASE AGREEMENT DATED OCTOBER 8, 1998

## MASTER GAS SALE/PURCHASE AGREEMENT

* * *

### ARTICLE XIV
### ARBITRATION

14.1 *Arbitration.* Except as otherwise provided in Section 12.1 or any Confirmation, any disagreement, difference, or dispute among the Parties arising under this Agreement shall be resolved pursuant to arbitration according to the procedures se forth in this Article XIV. Either Party may commence an arbitration proceeding hereunder by giving written notice to the other Party. No later than five (5) Business Days after the delivery of the notice commencing the arbitration proceeding, Seller and Buyer shall each select an arbitrator. Promptly following their selection, the arbitrators selected by Seller and Buyer jointly shall select a third arbitrator. The third arbitrator shall hear and decide all matters relating to the dispute that is subject to arbitration. All arbitrators selected under this Agreement shall have at least eight (8) years of professional experience in the commodity markets and in the business of marketing Gas, and shall not previously have been employed by either Party and shall not have a direct or indirect interest in either Party or the subject matter of the arbitration. The arbitration hearing shall commence as soon as is practical, but in no event later than thirty (30) days after the selection of the third arbitrator. If any arbitrator selected under this Section 14.1 should die, resign, or otherwise be unable to perform his duties hereunder, a successor arbitrator shall be selected pursuant to the procedures set forth in this Section 14.1.

*Appendix D*

14.2. *Law Governing Arbitration.* The arbitrator shall settle all disputes in accordance with the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association, to the extent that such Rules do not conflict with the terms of such Act or the provisions of this Agreement. The decision of the arbitrator shall be binding on the Parties and, if necessary, may be enforced in any court of competent jurisdiction. The charges and expenses of the arbitrators shall be shared equally by the Parties.

* * * *

## APPENDIX E — EXCERPT OF STATEMENT OF CLAIMS IN THE COURT OF ARBITRATION, AMERICAN ARBITRATION ASSOCIATION DATED APRIL 26, 2002

**IN THE COURT OF ARBITRATION**
**AMERICAN ARBITRATION ASSOCIATION**

**Arbitration No. 71 Y 19800887 1**

**METROMEDIA ENERGY, INC.**

**Claimant,**

**vs.**

**TXU ENERGY**

**Respondent**

**STATEMENT OF CLAIMS**

* * *

**IV.**
**Causes of Action**

4.1 *Breach of Contract.* TXU has failed to comply with the terms of the Agreement:

A. Pursuant to Section 74 of the Agreement, MME is entitled to audit the books and records of TXU to verify the accuracy of any

billing invoice, payment, demand, charge or calculation with respect to the relevant transaction. TXU has wholly failed to allow MME to inspect the records of TXU.

B. Pursuant to Section 7.2 of the Agreement, the parties agreed that disputed amounts are not due and payable until fifteen (15) days *after* final resolution of the dispute. MME has disputed over $12 million in winter 2000-2001 invoices by TXU for spot sales, which have not been resolved due to TXU's failure to provide any supporting documentation for its invoices. Therefore, said disputed amounts are not yet due. Nevertheless, TXU has exercised a letter of credit designed to secure payment when due. Since the dispute has not yet been resolved, TXU wrongfully drew on this line of Credit in the amount of $10 million.

C. TXU has further violated the Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases. Since TXU has not complied with Section 7.4 of the Agreement, MME cannot determine at this time the exact amount TXU has overcharged.

* * * *

**APPENDIX F — EXCERPT OF TXU ENERGY SERVICES N/K/A TXU ENERGY RETAIL COMPANY, L.P.'S SECOND AMENDED RESPONSE TO METROMEDIA ENERGY INC.'S STATEMENT OF CLAIMS AND ORIGINAL COUNTERCLAIM DATED JULY 29, 2002**

**BEFORE THE AMERICAN ARBITRATION ASSOCIATION**

**NO. 71 Y 198 00887 1**

**METROMEDIA ENERGY, INC.,**

**Claimant,**

**vs.**

**TXU ENERGY SERVICES n/k/a TXU ENERGY RETAIL COMPANY, L.P.,**

**Respondent.**

**TXU ENERGY SERVICES n/k/a TXU ENERGY RETAIL COMPANY, L.P.'S SECOND AMENDED RESPONSE TO METROMEDIA ENERGY INC.'S STATEMENT OF CLAIMS AND ORIGINAL COUNTERCLAIM**

* * *

*Appendix F*

## TXU ENERGY'S COUNTERCLAIMS

MME breached and continues to breach Article 7.1 of the Agreement by failing to share the Gross Profit with TXU Energy. Additionally, MME breached and continues to breach Article 7.4 of the Agreement by failing to provide documentation from which TXU Energy can calculate the share of Gross Profit to which it is entitled.

MME also breached and continues to breach Article 13.2 of the Agreement by failing to pay TXU Energy for MME's liquidated forward positions and other amounts owed, including interest.

* * * *

## APPENDIX G — EXCERPT OF PROCEEDINGS

[Commencing at page 4]

ARBITRATOR EDWARDS: I'd like to call the hearing on the merits in the arbitration brought by Metromedia Energy against TXU Energy Trading Company to order.

Are there any preliminary matters that either side wishes to take up this morning before we hear our first witness?

MR. CHISCANO: We do have – I have a couple matters, but probably the most important one is that we arrived to at least a partial settlement of the universal claims out there.

ARBITRATOR EDWARDS: That's terrific.

MR. CHISCANO: Mr. Lillard was kind enough to allow my clients and his clients to visit yesterday, and they did come to an amicable resolution to the outstanding amounts due and owing between the parties, which relates to TXU's counterclaims against Metromedia.

* * *

[16] Also in light of the settlement, Metromedia will withdraw its argument about wrongful withdraw on a letter of credit because that settlement kind of takes – takes care of that. So that issue, the claim for wrongful withdrawai, will not be pursued, which I believe in the Statement of Claims was section 4.1B is where it's set out there.

* * * *

## APPENDIX H — EXCERPT OF RESPONDENT'S POST-ARBITRATION BRIEF DATED DECEMBER 4, 2002

**BEFORE THE AMERICAN ARBITRATION ASSOCIATION**

**NO. 71 Y 198 00887 1**

**METROMEDIA ENERGY, INC.,**

**Claimant,**

**vs.**

**TXU ENERGY SERVICES n/k/a TXU ENERGY RETAIL COMPANY, L.P.,**

**Respondent.**

### RESPONDENT'S POST-ARBITRATION BRIEF

Respondent TXU Energy Services n/k/a TXU Energy Retail Company, L.P. ("TXU Energy")[1] files this post-arbitration brief as follows:

* * *

---

1. TXU Energy acquired Enserch Energy Services, Inc. in August 1997 but the name did not change until 1999. Tr. 718; *see also*, TXU Ex. 19. For consistency, we will use the name "TXU Energy" and not distinguish between TXU Energy and Enserch Energy Services, Inc. throughout this Brief.

*Appendix H*

## III.

## ARGUMENTS

### A. THE TRIAL TESTIMONY ESTABLISHES THAT TXU ENERGY DID NOT BREACH THE AGREEMENT BECAUSE THE AGREEMENT DOES NOT COVER THE PRICE OF SPOT GAS

#### 1. The Parties' Course Of Performance, Or Intent, Established A Separate Agreement For Spot Gas

The evidence establishes that through its course of performance initiated through its own actions, or based on the intent of the parties, MME created a separate contract that governed its spot gas transactions.

* * * *

2

FILED
DEC 1 - 2005
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 05-295

IN THE

# Supreme Court of the United States

METROMEDIA ENERGY, INC.,

*Petitioner,*

*v.*

ENSERCH ENERGY SERVICES, INC.; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP; TXU JOHN DOES,

*Respondents.*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## BRIEF IN OPPOSITION

THOMAS F. LILLARD
*Counsel of Record*
ROBERT K. WISE
MILES B. HABERER
HUNTON & WILLIAMS LLP
Energy Plaza
1601 Bryan Street, 30th Floor
Dallas, TX 75201
(214) 979-3000

LEDA DUNN WETTRE
ROBINSON & LIVELLI
Two Penn Plaza East
Newark, NJ 07105
(973) 690-5400

*Attorneys for Respondents*

198086

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

## QUESTION PRESENTED

Is an arbitrator's interpretation of the scope of the issues submitted, particularly when the parties fail to precisely set them out, as was the case here, reviewed by a federal court deferentially, as held by the Third Circuit below, or *de novo*, as maintained by Petitioner?

## CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Respondents[1] make the following disclosures:

1. Respondent TXU Energy Retail Company LP: Its general partner is TXU Retail Management Company LLC and its limited partner is TXU Energy Retail Investment Company LLC, both of which are owned by TXU Energy Company LLC, whose parent company is TXU US Holdings Company. TXU US Holdings Company's parent company is TXU Corp., a publicly held company.

2. Respondent TXU Energy Company LLC: Its parent company is TXU US Holdings Company, whose parent company is TXU Corp., a publicly held company.

3. Respondent Enserch Energy Services, Inc.: It no longer exists.

4. Respondent TXU Energy Trading: There is no company with this name. It was an assumed name of TXU Energy Trading Company LP, which no longer exists and which was indirectly owned by TXU Corp., a publicly held company.

---

1. Included among the defendants in this lawsuit were "TXU John Does," which were described in Paragraph 3 of MME's Amended Complaint as "fictional subsidiaries and/or affiliates of TXU Corp., which entities' specific identities are unknown at this time."

## TABLE OF CONTENTS


| | *Page* |
|---|---|
| QUESTION PRESENTED | i |
| CORPORATE DISCLOSURE STATEMENT | ii |
| TABLE OF CONTENTS | iii |
| TABLE OF CITED AUTHORITIES | v |
| STATEMENT OF THE CASE | 1 |
| A. MME's gas purchases from TXU Retail. | 1 |
| B. The arbitration proceeding. | 3 |
| C. This lawsuit. | 10 |
| D. The Petition. | 12 |
| REASONS FOR DENYING THE PETITION | 13 |
| A. MME waived its issue by failing to raise it in the Third Circuit. | 14 |
| B. The Third Circuit's decision below is consistent with the decisions of its sister Circuits and with this Court's decision in *First Options*. | 17 |
| 1. The Circuits agree that an arbitrator's interpretation of the scope of a submission is entitled to deference. | 19 |

*Contents*

*Page*

2. The Third Circuit's decision does not conflict with this Court's decision in *First Options*. ..... 24

C. The arbitration record conclusively establishes that MME and TXU Retail submitted the question of the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period to the Panel for determination. ..... 26

CONCLUSION ..... 29

## TABLE OF CITED AUTHORITIES

*Page*

### FEDERAL CASES

*$557,933.89, More or Less, in U.S. Funds*, 287 F.3d 66 (2d Cir. 2001) ..... 17

*187 Concourse Assocs. v. Fishman*, 399 F.3d 524 (2d Cir. 2005) ..... 23

*Adickes v. Kress & Co.*, 398 U.S. 144 (1970) ..... 14

*Advanced Technical Assocs., Inc. v. Segilman*, 39 F. Supp. 2d 1311 (D. Kan. 1999) ..... 22

*American Postal Workers Union v. Runyon*, 185 F.3d 832 (7th Cir. 1999) ..... 22

*Association of W. Pulp & Paper Workers, Local 78 v. Rexam Graphic, Inc.*, 221 F.3d 1085 (9th Cir. 2000) ..... 22

*Bakery, Confectionery & Tobacco Workers Local No. 262 v. Brown & Williamson*, 971 F.2d 652 (11th Cir. 1992) ..... 23

*Balojun v. Ashcroft*, 358 F.3d (7th Cir. 2004) ..... 17

*Boston & Maine Corp. v. Brotherhood of Maintenance of Way Employees*, 94 F.3d 15 (1st Cir. 1996) .. 21, 23

*Cited Authorities*

*Page*

*Bull HN Information Systems, Inc. v. Hutson*, 229 F.3d 321 (2000) ..... 19, 21

*Carpenters 46 N. Cal. Counties Conf. Bd. v. Zion Builders*, 96 F.3d 410 (9th Cir. 1996) ..... 23

*Coady v. Ashcraft & Gerel*, 223 F.3d 1 (1st Cir. 2000) ..... 23

*Coastal Oil of N. Eng., Inc. v. Teamsters Local 25*, 134 F.3d 466 (1st Cir. 1998) ..... 21

*Dow Corning Corp. v. Safety Nat'l Cas. Corp.*, 335 F.3d 742 (8th Cir. 2003) ..... 23

*E.I. Dupont de Nemours & Co. v. Local 900*, 968 F.2d 456 (5th Cir. 1992) ..... 23

*E.I. Dupont de Nemours & Co. v. Martinsville Nylon Employees' Council Corp.*, No. 94-2222, 1996 U.S. App. LEXIS 3208 (4th Cir. Feb. 28, 1996) ... 23

*El Dorado Technical Servs., Inc. v. Union Gen. de Trabajordores*, 961 F.2d 317 (1st Cir. 1992) .. 21, 22

*Executone Information Systems, Inc. v. Davis*, 26 F.3d 1314 (1994) ..... 20, 21, 22

*First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) ..... *passim*

*Cited Authorities*

*Page*

*GMC v. Pameia Equities Corp.*, 146 F.3d 242 (5th Cir. 1998) ..... 23

*General Warehousemen & Helpers Local 767 v. Standard Brands, Inc.*, 560 F.2d 700 (5th Cir.), *rev'd en banc*, 579 F.2d 1282 (1978), *cert. denied*, 443 U.S. 913, 99 S. Ct. 3103, 61 L. Ed. 877 (1979) ..... 21

*Herrmann Holding Ltd. v. Lucent Technologies, Inc.*, 302 F.3d 552 (5th Cir. 2002) ..... 17

*Howell v. Mississippi*, 125 S. Ct. 856 (2005) ..... 14

*International Ass'n of Machinists & Aerospace Workers v. Tennessee Valley Auth.*, 155 F.3d 767 (6th Cir. 1998) ..... 22

*Iron Workers Local No. 272 v. Bowen*, 624 F.2d 1255 (5th Cir. 1980) ..... 20, 22

*JLM Indus., Inc. v. Stolt-Nielsen SA*, 387 F.3d 163 (2d Cir. 2004) ..... 23

*John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48 (2d Cir. 2001) ..... 23

*John Morrell & Co. v. Local Union 304A*, 913 F.2d 544 (8th Cir. 1990) ..... 22, 23

*Cited Authorities*

*Page*

*KenAmerican Res., Inc. v. International Union*, 99 F.3d 1161 (D.C. Cir. 1996) ..... 23

*Kurt Orban Co. v. Angeles Metal Sys.*, 573 F.2d 739 (2d Cir. 1978) ..... 21

*Lattimer-Stevens Co. v. United Steelworkers of Am.*, 913 F.2d 1166 (6th Cir. 1990) ..... 22

*Local Union No. 898 v. XL Elec. Inc.*, 380 F.3d 868 (5th Cir. 2004) ..... 23

*Madison Hotel v. Hotel & Rest. Employees, Local 25*, 144 F.3d 855 (1998) ..... 19, 21, 22, 23

*Major League Umpires Ass'n v. American League of Prof'l Baseball Clubs*, 357 F.3d 272 (3d Cir. 2004) ..... 22

*Matteson v. Ryder Sys., Inc.*, 99 F.3d 108 (3d Cir. 1996) ..... 11, 16, 22

*Melrose Med. Group Part. Savs. Plan v. Bulger*, 243 F.3d 773 (3d Cir. 2001) ..... 17

*Metromedia Energy, Inc. v. Ensearch Energy Servs., Inc.*, 409 F.3d 574 (3d Cir. 2005) ..... 22

*Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299 (3d Cir. 1982) ..... 22

*Cited Authorities*

*Page*

*Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283 (9th Cir. 1989) ..... 22, 23, 24

*PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996) ..... 23

*Peabody W. Coal Co. v. District 22, United Mine Workers of Am.*, No. 03-15569, 99 Fed. Appx. 116 (9th Cir. May 18, 2004) ..... 22

*Richmond, Fredericksburg & Potomac R.R. v. Transportation Communications Int'l Union*, 973 F.2d 276 (4th Cir. 1992) ..... 22, 23

*Robertson v. American Airlines, Inc.*, 401 F.3d 499 (D.C. Cir. 2005) ..... 17

*Sarhank Group v. Oracle Corp.*, 404 F.3d 657 (2d Cir. 2005) ..... 23

*Sheet Metal Workers' Int'l Ass'n Local Union 359 v. Madison Indus., Inc.*, 84 F.3d 1186 (9th Cir. 1996) ..... 22

*Smith v. Currency Trading Int'l, Inc.*, No. 98-1311, 1999 U.S. App. LEXIS 18182 (10th Cir. Aug. 3, 1999) ..... 23

*Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. 2002) ..... 23

*Cited Authorities*


| | *Page* |
|---|---|
| *Tennessee v. Dunlop*, 426 U.S. 312 (1976) ..... | 14 |
| *Volvo GM Heavy Truck Corp. v. International Union*, No. 89-1515, 1990 WL 136644 (4th Cir. Sept. 24, 1990) ..... | 22 |
| *Yee v. Escondido*, 503 U.S. 519 (1992) ..... | 14 |

## STATEMENT OF THE CASE[2]

This case involves the review of an arbitration award that, among other things: (1) found that Respondent TXU Energy Retail Company LP (TXU Retail) did not overcharge Petitioner Metromedia Energy, Inc. (MME) for its "spot-market" natural gas purchases during the period from November 2000 through February 2001 (the Disputed Period); and (2) awarded TXU Retail one third of its attorneys' fees incurred in the arbitration as the "non-defaulting party" within the meaning of the attorneys' fees provision of a 1998 Master Gas Sale/Purchase Agreement (the Master Agreement) between MME and TXU Retail.

### A. MME's gas purchases from TXU Retail.

MME is a natural gas retailer that sells natural gas to end-users in the northeastern United States. As of October 8, 1998, it entered into the Master Agreement with TXU Retail's predecessor[3] to secure a portion of the natural gas it was contractually obligated to supply to its custc ers. Under the Master Agreement, MME could purchase gas from TXU Retail only pursuant to written confirmations that specified the purchase's term, volume, and price.

As natural gas prices began increasing significantly, MME shifted its customers from fixed-price contracts to "cost-plus" contracts so its customers would bear the risk of future gas price increases. It also began purchasing natural

2. The Petition for Writ of Certiorari will be cited as "Pet." The Petition's Appendix will be cited as "Pet.'s App."

3. The Master Agreement, which was executed by MME and Enserch Energy Services, Inc., was assigned to TXU Retail.

gas from TXU Retail on the spot-market, rather than under the Master Agreement, to meet the needs of its cost-plus contract customers. To do so, rather than negotiating a confirmation as required by the Master Agreement, MME telephoned TXU Retail and orally placed a market order for gas. TXU Retail, which like MME, was a natural gas retailer without its own gas supply, would, in turn, buy the gas from its wholesale-trading affiliate at the spot-market price, which was based on one of two industry-accepted market indices: *Gas Daily*'s index, which is used for daily transactions, and *Inside FERC*'s index, which is used for monthly transactions. The market price charged to TXU Retail by its wholesale-trading affiliate was known as the "internal transfer price," and was passed on to MME.

During the approximately two-year period in which MME purchased spot-market gas, TXU Retail's monthly invoices contained separate entries for gas purchased pursuant to confirmations under the Master Agreement (Confirmed Transactions) and on the spot-market. The invoices specifically identified spot-market purchases with the notation "spot-market," which was followed by the volume delivered and its price. The spot-market purchase price always differed from the Confirmed Transactions' price. In fact, before paying an invoice, MME compared its spot-market price to *Gas Daily*'s index for the relevant period to confirm that it had been charged the market price.

During the winter of 2000-2001, natural gas prices skyrocketed as a result of unusually cold weather, increasing from about $4 per MMBtu to more than $23 per MMBtu. Apparently unable to pass through the high prices to certain of its cost-plus customers, MME claimed for the first time that the spot-market gas price was governed by the Master

Agreement's pricing provisions and demanded, pursuant to the agreement, that TXU Retail provide it with cost information about the spot-market gas sold to MME during the Disputed Period. In addition, MME, which already was greatly in arrears on its payments to TXU Retail for other gas deliveries,[4] refused to pay for the spot-market gas deliveries during that period.

**B. The arbitration proce ding.**

Unhappy with the cost information provided by TXU Retail, MME, on October 11, 2001, sent TXU Retail a cryptic notice stating that MME "hereby gives notice pursuant to Article 14 of its Master Agreement with TXU of commencement of arbitration of the disputes between MME and TXU which are subject to that provision. . . ."[5] A few months later, MME made a "Demand for Arbitration." The demand described the parties' dispute as follows: "MME bought natural gas from TXU. . . . [The] Contract calls for the price to be based on TXU's cost. Claimant believes TXU charged substantially more than called for under contract. TXU refuses to provide cost information. . . ." As relief, the demand sought "information regarding TXU's cost. Based on one month's cost data . . . , the claim will be in excess of $2,000,000. . . ."

---

4. Shortly before this dispute arose, MME was more than $18 million in arrears on its payments to TXU Retail for its natural gas purchases.

5. Under the Master Agreement either party could submit "any disagreement, difference, or dispute among the Parties arising under this Agreement" to arbitration in accordance with "the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association." Pet.'s App. at 43a.

As required by the Master Agreement, a three-member arbitration panel (the Panel), consisting of an arbitrator appointed by MME, an arbitrator appointed by TXU Retail, and a neutral arbitrator, who had the sole authority to "hear and decide all matters relating to the dispute," was empaneled by the American Arbitration Association. Pet.'s App. at 42a. Unfortunately, the parties failed to create a single, comprehensive document that set forth the precise issues the Panel was to decide. Rather, on April 26, 2002, MME, at the request of the neutral arbitrator, filed its "Statement of Claims." Paragraph 4.1 of the statement alleged the following contract breaches: (1) breach of Section 7.4 of the Master Agreement because TXU Retail failed to allow MME to inspect its records; (2) breach of Section 7.2 of the Master Agreement because TXU Retail improperly exercised MME's letter of credit;[6] and (3) TXU Retail's "violat[ion] of the [Master] Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases." Notwithstanding this last claim, the statement's "prayer for relief" oddly did not seek damages for the alleged overcharges. Instead, it asked the Panel to order TXU Retail to: (1) "produce its books and records to MME . . . ;" (2) return all amounts drawn under the letter of credit . . . until such time that TXU can prove all amounts allegedly due and owing;" (3) declare "that the [Master] Agreement does not allow TXU [Retail] to obtain gas from its affiliate corporation, mark up the wholesale cost of the gas as if it was purchased from a non-affiliated third party, and claim

6. As pointed out above, MME refused to pay for its spot-market gas purchases during the Disputed Period. In addition, as it also owed TXU Retail millions more for gas purchases under Confirmed Transactions, TXU Retail exercised a $10 million letter of credit provided by MME to secure its payment for its natural gas purchases.

this is the proper cost of gas to MME under the Agreement;"[7] and (4) award MME its costs and attorneys' fees.

TXU Retail's response to MME's "Statement of Claims," among other things, denied that the Master Agreement covered MME's spot-market gas purchases. Relying on Section 2-208 of the Uniform Commercial Code, the response maintained that the parties' two-year course of performance relating to such purchases "establishes a separate and distinct contract regarding the price for spot gas, or, in the alternative, provides additional contract terms regarding the price of spot gas[,]" and that, pursuant to the course of performance, spot gas was priced at market. In addition, TXU Retail counterclaimed against MME for breach of the Master Agreement because MME failed to pay TXU Retail: (1) a portion of its gross profit on the resale of the gas it purchased under the Master Agreement, as required by the agreement; and (2) for "liquidated forward positions and other amounts owed."

After more than a year of discovery, a three-day arbitration hearing was held in September 2002. In anticipation of the hearing, both parties filed pre-arbitration briefs. MME's brief greatly modified its claims and theories. Despite the failure of its "Statement of Claims" to request damages for alleged spot-market gas overcharges during the Disputed Period, MME, in its brief, requested more than $7 million in such damages. Moreover, MME's brief asserted an entirely new theory regarding why it had been overcharged for some spot-market gas. Unlike its arbitration demand and its "Statement of Claims," which alleged that MME was to be charged TXU Retail's wholesale-trading affiliate's actual

7. Although virtually unintelligible, this refers to TXU Retail's internal transfer price.

gas cost for spot-market gas (as allegedly required by the Master Agreement's pricing provisions), MME's brief for the first time claimed that the Confirmed Transactions were "full requirements contracts" that required TXU Retail to sell MME not only the gas volumes specified in the confirmations, but also any additional spot-market gas used by the customers, at the confirmation's fixed price. Thus, MME bifurcated its overcharge claim, alleging that it was to be charged two different prices for spot-market gas: the Confirmed Transactions' price for spot-market gas delivered to MME's Confirmed Transactions customers and the Master Agreement's price, which it contended was TXU Retail's wholesale-trading affiliate's cost, for spot-market gas delivered to its other customers.[8]

TXU Retail's Pre-Arbitration Brief, consistent with its response to MME's "Statement of Claims," reiterated its position that the parties' course of performance either modified the Master Agreement or resulted in a separate course-of-performance contract pursuant to which spot-market gas purchases were priced at market. Also, believing that MME was challenging the reasonableness of its internal transfer price during the Disputed Period, the brief clearly stated that TXU Retail would adduce testimony during the hearing establishing that the internal transfer price was reasonable because it was "well within the market price ranges published in both *Inside FERC* and *Gas Daily*."

Immediately before the arbitration hearing began, the parties advised the Panel that MME had agreed to pay TXU Retail about $2 million in settlement of TXU Retail's

8. MME's Pre-Arbitration Brief also recognized, and attempted to refute, TXU Retail's position that the spot-market gas price was the market price pursuant to the parties' course of performance.

counterclaims. The parties also advised the Panel that they had agreed that there was to be one final arbitration award in the case, incorporating both the Panel's decision regarding MME's claims and the settlement of TXU's counterclaims.

During the hearing, *both* parties adduced evidence about the proper spot-market gas price during the Disputed Period, with TXU Retail presenting expert testimony, without objection from MME, establishing that its internal transfer price during the Disputed Period was reasonable because it was within the range of the relevant gas-market price indices. Also, during the hearing, MME once again significantly modified its claims. Among other things, it contended for the *first* time that it was damaged because TXU Retail's spot-market gas charges during the Disputed Period exceeded the market price, thereby preventing MME from passing the full cost through to certain customers under their cost-plus contracts (MME's Pass-Through Claim or the Pass-Through Claim). As a result of this new claim, the Panel, at the arbitration hearing's conclusion, held the record open so MME could present additional evidence to support it.

In addition, after the hearing's conclusion, the neutral arbitrator wrote the parties a letter (the Neutral Arbitrator's Post-Hearing Letter) squarely placing them on notice that the Panel would decide the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period. In this regard, the letter asked the parties to provide information to the Panel so it could determine if TXU Retail's spot-market gas charges during the Disputed Period reflected the market price.

MME did *not* complain to the neutral arbitrator that a determination of the reasonableness of TXU Retail's spot-

market gas charges during the Disputed Period was outside the scope of the parties' submissions or that the information sought by his letter was irrelevant for that reason. Instead, MME, as well as TXU Retail, supplemented the arbitration record about MME's Pass-Through Claim and provided the information requested by the Neutral Arbitrator's Post-Hearing Letter. In addition, they filed post-hearing briefs.

Needless to say, MME's brief argued that the Master Agreement or the Confirmed Transactions set the spot-market gas price and increased MME's damages from the alleged overcharges to more than $7.4 million. TXU Retail's brief reiterated its course-of-performance argument and further argued that the spot-market gas price was the market price, that its internal transfer price during the Disputed Period was reasonable because it was in the range of the relevant gas-market price indices during that period, and that MME's alleged inability to pass through the spot-market gas price to certain of its cost-plus contract customers during the Disputed Period was not the result of TXU Retail's alleged overcharges. Even though TXU Retail's post-hearing brief

> made it crystal clear that TXU [Retail] believed that the [Panel was] empowered to address the reasonableness of TXU [Retail's] spot-market prices during the Disputed Period, MME chose not to send a letter or seek leave to file a reply challenging TXU [Retail's] submission of an issue that MME had (supposedly) not agreed to arbitrate.

Pet.'s App. at 18a.

The Arbitration Award was issued on March 3, 2003. Pet.'s App. at 30a-38a. Even MME's appointed arbitrator flatly rejected MME's claim that the Master Agreement and/or the Confirmed Transactions set the spot-market gas price. Instead, the Panel unanimously found that a separate course-of-performance contract set the price at market and that TXU Retail's internal transfer price during the Disputed Period was fair and reasonable because it was within the range of the relevant gas-market price indices during that period. *Id.* at 33a-36a. Accordingly, the Panel ordered MME to pay TXU Retail "the amount of $1,830,866.19"[9] and "one-third of its attorneys' fees . . . and . . . costs excluding the fees of its appointed arbitrator." *Id.* at 36a. The Panel finally ordered TXU Retail to submit "affidavits" to the neutral arbitrator establishing its attorneys' fees and costs and allowed MME to "challenge the reasonableness of any charge." *Id.* at 37a.

Even though MME (supposedly) believed that the attorneys' fees award was a direct result of the Panel's improper determination of the reasonableness of TXU Retail's spot-market gas prices during the Disputed Period, MME failed either to send a letter to the Panel objecting to the award on that basis or to file a motion for its reconsideration on that basis. Instead, in responding to TXU Retail's attorneys' fees' affidavits, MME only argued that TXU Retail was not entitled to recover its attorneys' fees because TXU Retail's own actions – its failure to provide MME with information about the cost of the spot-market gas sold to MME during the Disputed Period – necessitated the arbitration. *Id.* at 39a-40a. The Panel rejected MME's

9. This amount included an offset to the settlement amount of about $174,000 because of accounting errors and other matters raised by the Panel in its audit of TXU Retail's charges for spot-market gas during the Disputed Period. Pet. App. at 35a-36a.

argument and awarded TXU Retail about $126,000 in attorneys' fees and costs in its "Final Order." *Id.*[10]

**C. This lawsuit.**

Needless to say the arbitration was a disaster for MME – not only did the Panel reject its claim that it was overcharged for spot-market gas during the Disputed Period, but it also ordered MME to pay TXU Retail about $2 million for its Master Agreement breaches and to reimburse TXU Retail for its arbitration expenses. Unwilling to accept this result, MME fired the attorneys who represented it in the arbitration and hired new ones to commence this action in an attempt to relitigate the issue of whether it had been overcharged for its spot-market gas purchases during the Disputed Period. Accordingly, its pleadings in the District Court sought: (1) to vacate the arbitration award to the extent that it found that TXU Retail's spot-market gas charges were reasonable during the Disputed Period and awarded TXU Retail attorneys' fees; and (2) damages from TXU Retail for the alleged overcharges.

Both parties moved for summary judgment. The District Court granted MME's motion, holding that the Panel exceeded its authority by: (1) determining the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period because the only issue in the arbitration was whether the Master Agreement set the spot-market gas price; and (2) awarding TXU Retail attorneys' fees because the award necessarily was based on the Panel's inappropriate decision that TXU Retail's spot-market gas charges during the Disputed Period were reasonable.

---

10. The "Final Order" erroneously refers to TXU Energy Trading Co. instead of TXU Retail.

TXU Retail (and the other Respondents) appealed to the Third Circuit. With respect to the district court's ruling regarding the Panel's determination of the reasonableness of its spot-market gas charges during the Disputed Period, TXU Retail, after pointing out that the parties, during the arbitration, had failed to set forth the precise issues the Panel was to decide in a single, comprehensive document or otherwise, framed the issue in terms of whether the parties submitted the spot-market gas charges' reasonableness to the Panel for determination. Citing the Third Circuit's decision in *Matteson v. Ryder Sys., Inc.*, 99 F.3d 108, 113 (3d Cir. 1996), TXU Retail argued that the Panel's interpretation of the scope of the submitted issues was entitled to the same far-reaching respect and deference accorded to its findings of fact and interpretations of the law, and concluded that MME and TXU Retail's arbitration pleadings, briefs, and conduct provided a reasonable, if not conclusive, basis for the Panel to conclude that it was empowered to decide the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period.

With respect to the attorneys' fees award, TXU Retail argued that the District Court improperly vacated the award because it ignored the Panel's finding that TXU Retail was the "non-defaulting Party" under the Master Agreement's attorneys' fees provision, not because it determined that TXU Retail's spot-market gas charges during the Disputed Period were reasonable, but rather because it first concluded that the "non-defaulting Party," under the Master Agreement's attorneys' fees provision, was the arbitration's "prevailing party," that is, the party who obtained the largest monetary recovery in the arbitration, and then found TXU Retail was the "prevailing party" as it obtained the largest (and the only) monetary recovery in the arbitration by virtue of the settlement of its counterclaims.

MME's Third Circuit Brief failed to challenge TXU Retail's assertion that both the District Court and the Third Circuit were required to review the Panel's interpretation of the scope of the parties' submission deferentially. Instead, after agreeing that a deferential standard of review applied, MME simply argued that the District Court properly deferred to the Panel's interpretation of the scope of the submission because it allegedly carefully reviewed the arbitration record.

The Third Circuit agreed with TXU Retail. After holding that an arbitrator's interpretation of the scope of a submission was entitled to deference, the Third Circuit concluded that the arbitration "record as a whole provided an adequate basis upon which the [Panel] could conclude that it was empowered to address the reasonableness of TXU [Retail's] spot-gas prices in the event that a course-of-performance contract rather than the Master Agreement governed the parties' spot-gas transactions." Pet.'s App. at 15a. It also held that the District Court incorrectly vacated the attorneys' fees award for the reason set forth by TXU Retail in its Opening Brief. *Id.* at 19a-20a. Accordingly, the Third Circuit reversed the District Court's decision and remanded the case with instructions to enter judgment in favor of TXU Retail. *Id.* at 20a.

**D. The Petition.**

Unwilling to accept its loss in the Third Circuit, MME once again fired its attorneys and hired new ones to petition this Court for a writ of certiorari. Wholly ignoring the fact that MME's Third Circuit Brief never argued that a federal court is required to review an arbitrator's interpretation of the scope of a submission *de novo*, rather than deferentially, the Petition contends for the first time in this proceeding

that: (1) the decision below should be reversed because the Third Circuit applied the wrong standard of review; and (2) when the Panel's interpretation of the scope of the parties' submission is reviewed *de novo*, it becomes clear that the question of the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period was not submitted to the Panel for determination.

## REASONS FOR DENYING THE PETITION

The Petition should be denied for three reasons. First, as pointed out above, MME never suggested, much less argued, in its Third Circuit Brief that the Panel's interpretation of the scope of the submitted issues should be reviewed *de novo*. Rather, it acknowledged in its Third Circuit Brief that such interpretation was to be reviewed deferentially, and even argued that the District Court properly deferred to the Panel's interpretation of the scope of the parties' submission. Accordingly, MME waived its argument that the Third Circuit applied the wrong standard of review below.

Second, and more important, MME's argument creates a false conflict among the Circuits and with this Court's decision in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), by confusing the standard of a federal court's review of an arbitrator's interpretation of the scope of a submission with the standard of a federal court's review of the question of arbitrability – whether the parties agreed to arbitrate in the first instance. When the issues are untangled and considered separately, it becomes crystal clear that: (1) there is no conflict among the Circuits regarding the proper standard of review of an arbitrator's interpretation of the scope of a submission because *every* Court of Appeals

that has directly considered the question has held, like the Third Circuit did below, that a federal court's review of an arbitrator's interpretation of the scope of a submission is highly deferential; and (2) the Third Circuit's decision below does not conflict with this Court's decision in *First Options* because *First Options* applies solely to the standard of review of an arbitrator's determination of arbitrability, and not to an arbitrator's interpretation of the scope of a submission.

Third, even if MME had not waived its issue by failing to raise it in the Third Circuit and even if a federal court is required to review an arbitrator's interpretation of the scope of a submission *de novo*, the Petition still should be denied because the arbitration record conclusively establishes that MME and TXU Retail submitted the question of the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period to the Panel for determination.

**A. MME waived its issue by failing to raise it in the Third Circuit.**

This Court does *not* grant certiorari to decide an issue that was not raised in the Court of Appeals, irrespective of its significance or novelty. As noted by this Court in *Adickes v. Kress & Co.*, 398 U.S. 144, 148 n.1 (1970): "Where issues are neither raised before nor considered by the Court of Appeals, this Court will not ordinarily consider them." *Accord*, *Howell v. Mississippi*, 125 S. Ct. 856, 860 (2005); *Yee v. Escondido*, 503 U.S. 519, 533 (1992); *Tennessee v. Dunlop*, 426 U.S. 312, 316 n.3 (1976).

Here, MME never raised the issue it asks this Court to resolve in the Third Circuit (or the District Court). It never argued in the Third Circuit (or the District Court) that a

*de novo*, rather than a deferential, standard of review applied to a federal court's review of an arbitrator's interpretation of the scope of a submission. Rather, in its Third Circuit Brief, MME agreed with TXU Retail that a deferential standard of review applied.

For example, TXU Retail's Opening Brief in the Third Circuit presented two broad issues: one with respect to the propriety of the Panel's finding that TXU Retail's spot-market gas charges during the Disputed Period were reasonable (the Scope Issue) and an another with respect to the propriety of the attorneys' fees award. The Scope Issue was framed in terms of whether the parties submitted the question of the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period to the Panel for determination. In this regard, TXU Retail's Opening Brief in the Third Circuit set forth the applicable standard of review of the Panel's interpretation of the scope of the parties' submission as follows:

> [A]n arbitrator's view of the scope of the submitted issues is entitled to the same far-reaching respect and deference that is normally accorded to his findings of fact and interpretations of the law. As noted by this Court: "[T]here is no doubt that our review of the interpretation of a submission is highly deferential[,]" *Matteson*, 99 F.3d at 113, and "'there must be *absolutely no support at all* in the record justifying the arbitrator's determinations for a court to deny enforcement of the award[,]'" *id.* at 113 (*quoting News Am. Pub., Inc. v. Newark Typographical Union, Local 103*, 918 F.2d 21, 24 (3d Cir. 1990) (emphasis added)). . . .

*See* TXU's Opening Br. at 27 (emphasis in original).

After setting forth this deferential standard of review, the introduction to the Brief's argument on the Scope Issue pointed out that the district court's holding on the issue "is wrong, however, because it is contrary to the arbitration record and fails to give the appropriate deference to the Panel's view of the issues submitted to it." *Id.* at 19. Moreover, the fourth subpoint in that argument made it clear that TXU Retail believed that a deferential standard of review applied and that the District Court erred in failing to apply one. For example the subpoint's heading read: "The district court failed to give the Panel's determination of the issues submitted to it the far-reaching respect and deference to which it is entitled." *Id.* at 43.

MME, in its Third Circuit Brief, agreed that a federal court reviews an arbitrator's interpretation of the scope of a submission deferentially. In fact, not only was the Third Circuit's decision in *Matteson v. Ryder Systems, Inc., supra*, the *most* cited case in MME's Third Circuit Brief, but the Brief also cited this Court's decision in *First Options of Chicago, Inc. v. Kaplan*, whose holding, MME now contends conflicts with the Third Circuit's application of a deferential standard of review below, Pet. at 18-21, *only* for the proposition that, in reviewing a district court's decision upholding or vacating an arbitration award, an appellate court reviews the district court's findings of fact for clear error and its conclusions of law *de novo*.

In sum, MME not only failed to raise the question of the proper standard of review in the Third Circuit, but in its Third Circuit Brief, it agreed with TXU Retail that a deferential standard of review applied to the issue in this case – how a federal court reviews an arbitrator's interpretation of the

scope of a submission.[11] Accordingly, this Court should deny the Petition.

**B. The Third Circuit's decision below is consistent with the decisions of its sister Circuits and with this Court's decision in *First Options*.**

Neither MME nor TXU Retail ever claimed during the arbitration that their dispute, or any portion of it, was not arbitrable. Just as important, they failed to provide the Panel with the precise issues it was to decide either in a single, comprehensive document or otherwise. Based on MME and TXU Retail's pleadings, briefs, and conduct during the arbitration, the Panel concluded that one of the submitted issues was whether TXU Retail's spot-market gas charges during the Disputed Period were reasonable.

Unhappy with the Panel's resolution of that issue, MME commenced this action to vacate the arbitration award. In doing so, it never claimed that the Panel lacked jurisdiction over the parties' dispute, or any part of it, because there was no arbitration agreement. Rather, after acknowledging that the Master Agreement required the parties to arbitrate their dispute, MME argued that the Panel had exceeded its authority by deciding an issue that allegedly had not been submitted to it – the reasonableness of TXU Retail's spot-

---

11. It is well settled that a party's failure to raise an issue in its brief waives the issue in the court of appeals. *E.g.*, *Robertson v. American Airlines, Inc.*, 401 F.3d 499, 504 n.2 (D.C. Cir. 2005); *Balojun v. Ashcroft*, 358 F.3d 464, 465 (7th Cir. 2004); *Herrmann Holding Ltd. v. Lucent Technologies, Inc.*, 302 F.3d 552, 562 n.2 (5th Cir. 2002); *$557,933.89, More or Less, in U.S. Funds*, 287 F.3d 66, 78 (2d Cir. 2001); *Melrose Med. Group Part. Savs. Plan v. Bulger*, 243 F.3d 773, 783 (3d Cir. 2001).

market gas charges during the Disputed Period. Thus, the issue before the Third Circuit was whether the Panel properly interpreted the scope of the parties' submission. In deciding that issue, the Third Circuit followed its long-standing precedent and held that the Panel's interpretation of the scope of the parties' submission was entitled to deference. Pet.'s App. at 10a, 14a-15a.

MME argues that a writ of certiorari should be granted because: (1) there is a conflict among the Circuits regarding the proper standard of review of an arbitrator's interpretation of the scope of a submission, with some Circuits reviewing the arbitrator's interpretation deferentially, as the Third Circuit did below, and others reviewing it *de novo*, Pet. at 12-18; and (2) the Third Circuit's deferential standard of review conflicts with this Court's decision in *First Options*, which it claims requires a federal court to review an arbitrator's interpretation of the scope of a submission *de novo*, Pet. at 18-22. MME, however, has created a *false* conflict by confusing two separate and distinct issues: the standard of review of an arbitrator's determination of arbitrability – whether the parties have agreed to arbitrate in the first instance – and the standard of review of an arbitrator's interpretation of the scope of a submission. When these issues are viewed separately, as they must be, it becomes clear that the Third Circuit applied the correct standard of review.

### 1. The Circuits agree that an arbitrator's interpretation of the scope of a submission is entitled to deference.

At the outset, the Courts of Appeals have recognized that different standards of review apply to an arbitrator's interpretation of the scope of a submission and to an arbitrator's determination of arbitrability. For example, the D.C. Circuit, in a case decided after *First Options*, explained that

> [t]his question—the scope of the submission to the arbitrator—should not be confused with the question of arbitrability—whether the employer and union agreed in the collective bargaining agreement to put a particular issue to arbitration. The latter question is reviewed by a federal court *de novo*. The former, as we have just indicated, is not.

*Madison Hotel v. Hotel & Rest. Employees, Local 25*, 144 F.3d 855, 857 n.1 (1998). The First Circuit made the same distinction in *Bull HN Information Systems, Inc. v. Hutson*, 229 F.3d 321 (2000), which also was decided after *First Options*. After holding that, when the issue is whether an arbitrator exceeded his authority by deciding an issue not submitted to him, "'the arbitrator's interpretation of the scope of the issue submitted to him is to be treated with great deference,'" *id.* at 332 (quoting *Federated Dep't Stores v. United Food & Commercial Workers Union, Local 1442*, 901 F.2d 1494, 1498 (9th Cir. 1990)), the court explained that

> [t]his case is distinguished from one in which a court asked to compel arbitration determines, in

> the first instance, whether the parties agreed to arbitrate their dispute at all. In that type of case, 'the court is to make this determination by applying the federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the [Federal Arbitration] Act. . . .'

*Id.* at 332 n.8 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985)). Finally, the Fifth Circuit in *Executone Information Systems, Inc. v. Davis*, 26 F.3d 1314 (1994), which was decided before *First Options*, also distinguished the standard of review a federal court applies to an arbitrator's interpretation of the scope of a submission from his or her determination of arbitrability. After holding that the arbitrability determination is reviewed *de novo*, *id.* at 1321, the court took

> note of the view expressed by our sister circuits that the arbitrator's interpretation of the scope of the issues submitted to him is entitled to the same judicial deference accorded his interpretation of the agreement being arbitrated, but [found] it unnecessary to adopt or reject that view given the clear facts of this case.

*Id.* at 1321 n.1 (citations omitted).[12]

---

12. Notwithstanding the fact that in *Executone Information Systems, Inc.*, the Fifth Circuit expressly declined to decide the proper standard of review of an arbitrator's interpretation of the scope of a submission, the Petition incorrectly cites it for the proposition that the Fifth Circuit reviews such an interpretation *de novo*. Pet. at 13. It also incorrectly cites *Iron Workers Local No. 272 v. Bowen*, 624

(Cont'd)

More important, there is *no* conflict among the Circuits regarding the standard of review of an arbitrator's interpretation of the scope of a submission. *Every* Circuit that has considered the question, both before and after *First Options*, has held that a federal court reviews such an interpretation deferentially. *E.g.*, *Bull HN Info. Sys., Inc.*, 229 F.3d at 332; *Coastal Oil of N. Eng., Inc. v. Teamsters Local 25*, 134 F.3d 466, 469 (1st Cir. 1998); *Boston & Maine Corp. v. Brotherhood of Maintenance of Way Employees*, 94 F.3d 15, 19 (1st Cir. 1996); *El Dorado Technical Servs., Inc. v. Union Gen. de Trabajordores*, 961 F.2d 317, 321 (1st Cir. 1992); *Kurt Orban Co. v. Angeles Metal Sys.*,

(Cont'd)

F.2d 1255 (5th Cir. 1980), for the same proposition, *id.* at 14, even though there, the Fifth Circuit, as it later did in *Executone Information Systems, Inc.*, declined to decide the issue:

> We note that *General Warehousemen & Helpers Local 767 v. Standard Brands, Inc.*, 560 F.2d 700, 707-08 n.8 (5th Cir.), *rev'd en banc on other grounds*, 579 F.2d 1282 (1978), *cert. denied*, 443 U.S. 913, 99 S. Ct. 3103, 61 L. Ed. 877 (1979) (citing *United Steel Workers of America v. United States Gypsum Co.*, 492 F.2d 713, 732 (5th Cir.), *cert. denied*, 419 U.S. 998, 95 S. Ct. 312, 42 L. Ed. 2d 271 (1974)), suggests that "disputes over the scope of a submission are themselves to be resolved by the arbitrator." But since in this case the court's construction of the issue submitted was precisely the same as the arbitrator's, we need *not* resolve whether the court's or the arbitrator's version would prevail if they differed.

*Id.* at 1264 n.18 (emphasis added).

Finally, the Petition fails to cite *Bull HN Information Systems, Inc.* and, although it cites *Madison Hotel*, it ignores the distinction the D.C. Circuit made between the standard of review of an arbitrator's determination of arbitrability and the standard of review of an arbitrator's interpretation of the scope of a submission. *See* Pet. at 16.

573 F.2d 739, 740 (2d Cir. 1978); *Metromedia Energy, Inc. v. Ensearch Energy Servs., Inc.*, 409 F.3d 574, 578, 579 (3d Cir. 2005); *Major League Umpires Ass'n v. American League of Prof'l Baseball Clubs*, 357 F.3d 272, 279 (3d Cir. 2004); *Matteson*, 99 F.3d at 113; *Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir. 1982); *Richmond, Fredericksburg & Potomac R.R. v. Transportation Communications Int'l Union*, 973 F.2d 276, 280 (4th Cir. 1992); *Volvo GM Heavy Truck Corp. v. International Union*, No. 89-1515, 1990 WL 136644, at *2 (4th Cir. Sept. 24, 1990); *International Ass'n of Machinists & Aerospace Workers v. Tennessee Valley Auth.*, 155 F.3d 767, 772 (6th Cir. 1998); *Lattimer-Stevens Co. v. United Steelworkers of Am.*, 913 F.2d 1166, 1170 (6th Cir. 1990); *American Postal Workers Union v. Runyon*, 185 F.3d 832, 835-36 (7th Cir. 1999); *John Morrell & Co. v. Local Union 304A*, 913 F.2d 544, 560 (8th Cir. 1990); *Association of W. Pulp & Paper Workers, Local 78 v. Rexam Graphic, Inc.*, 221 F.3d 1085, 1087 (9th Cir. 2000); *Peabody W. Coal Co. v. District 22, United Mine Workers of Am.*, No. 03-15569, 99 Fed. Appx. 116, 117 (9th Cir. May 18, 2004); *Sheet Metal Workers' Int'l Ass'n Local Union 359 v. Madison Indus., Inc.*, 84 F.3d 1186, 1190 (9th Cir. 1996); *Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 285-86 (9th Cir. 1989); *Madison Hotel*, 144 F.3d at 857.[13]

---

13. No Fifth, Tenth, Eleventh, or Federal Circuit decisions have been found that decide the issue, although one district court in the Tenth Circuit has held that an arbitrator's interpretation of the scope of a submission is reviewed deferentially, *Advanced Technical Assocs., Inc. v. Segilman*, 39 F. Supp. 2d 1311, 1316 (D. Kan. 1999) (citing *El Dorado Technical Servs., Inc.*, 961 F.2d at 321). Moreover, with the exception of *Executone Information Systems, Inc.*, 26 F.3d at 1321 n.1, and *Iron Workers Local No. 272*, 624 F.2d at 1264 n.18, in which the Fifth Circuit declined to decide it, the cases cited by MME for the proposition that the Second, Fifth, Tenth, and Eleventh Circuits review an arbitrator's

(Cont'd)

There are several reasons why the Circuits uniformly have held that an arbitrator's interpretation of the scope of a submission is entitled to deference. First, "deference to an

---

(Cont'd)

interpretation of a submission's scope *de novo* did not involve that issue. *See* Pet. at 13-14. Rather, they either set forth the standard of review of arbitrability, *Sarhank Group v. Oracle Corp.*, 404 F.3d 657, 661-62 (2d Cir. 2005); *JLM Indus., Inc. v. Stolt-Nielsen SA*, 387 F.3d 163, 169, 171 (2d Cir. 2004); *Specht v. Netscape Communications Corp.*, 306 F.3d 17, 26-27 (2d Cir. 2002); *John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48, 53, 57-58 (2d Cir. 2001); *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193, 1198 (2d Cir. 1996), *Local Union No. 898 v. XL Elec. Inc.*, 380 F.3d 868, 870 (5th Cir. 2004); *GMC v. Pamela Equities Corp.*, 146 F.3d 242, 247-50 (5th Cir. 1998); *Smith v. Currency Trading Int'l, Inc.*, No. 98-1311, 1999 U.S. App. LEXIS 18182, at *5 (10th Cir. Aug. 3, 1999); *Bakery, Confectionery & Tobacco Workers Local No. 262 v. Brown & Williamson*, 971 F.2d 652, 655 (11th Cir. 1992), or for a district court's decision upholding or vacating an arbitration award, *187 Concourse Assocs. v. Fishman*, 399 F.3d 524, 526-27 (2d Cir. 2005); *E.I. Dupont de Nemours & Co. v. Local 900*, 968 F.2d 456, 458 (5th Cir. 1992).

In the same vein, MME's claim that decisions within the First, Fourth, Eighth, Ninth, and D.C. Circuits stand in "confusing disarray," Pet. at 16-17, is based on an "apples-to-oranges" comparison of cases setting forth the standard of review of an arbitrator's interpretation of the scope of a submission, *e.g.*, *Madison Hotel*, 144 F.3d at 857; *Boston & Maine Corp.*, 94 F.3d at 19; *Richmond, Fredericksburg & Potomac R.R.*, 973 F.2d at 280; *John Morrell & Co.*, 913 F.2d at 560; *Pack Concrete, Inc.*, 866 F.2d at 285-86, with cases setting forth the standard of review of arbitrability, *e.g.*, *Dow Corning Corp. v. Safety Nat'l Cas. Corp.*, 335 F.3d 742, 747 (8th Cir. 2003); *Coady v. Ashcraft & Gerel*, 223 F.3d 1, 9 (1st Cir. 2000); *KenAmerican Res., Inc. v. International Union*, 99 F.3d 1161, 1163 (D.C. Cir. 1996) (same); *Carpenters 46 N. Cal. Counties Conf. Bd. v. Zion Builders*, 96 F.3d 410, 414 (9th Cir. 1996); *E.I. Dupont de Nemours & Co. v. Martinsville Nylon Employees' Council Corp.*, No. 94-2222, 1996 U.S. App. LEXIS 3208, at *7-8 (4th Cir. Feb. 28, 1996).

arbitrator's interpretation of a submission follows from [this Court's] directive that 'when the subject matter of a dispute is arbitrable, 'procedural' questions which grow out of the dispute and bear on its final disposition are to be left to the arbitrator.'" *Pack Concrete, Inc.*, 866 F.2d at 285 (quoting *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 40 (1987)). Second, "[f]ailure to adopt this [deferential] standard would require the judiciary 'to determine, case by case, the exact scope of submission in the endless number'" of arbitrations, *id.* (quoting *Mobil Oil Corp.*, 679 F.2d at 302), and such plenary review would undermine the federal policy underlying arbitration as "an expeditious and relatively inexpensive means of resolving disputes," *id.*; *accord*, *Mobil Oil Corp.*, 679 F.2d at 302. Finally, "interpreting the issue submitted often requires construction of the agreement itself, a job clearly for the arbitrator." *Pack Concrete, Inc.*, 866 F.2d at 285-86; *accord*, *Mobil Oil Corp.*, 679 F.2d at 302.[14]

### 2. The Third Circuit's decision does not conflict with this Court's decision in *First Options*.

The Third Circuit's decision below does not conflict with this Court's decision in *First Options*. *First Options* only involved the question of the proper standard of review of an arbitrator's determination of arbitrability, and not the question of the proper standard of review of an arbitrator's interpretation of the scope of a submission. 514 U.S. at 940, 942. Moreover, if anything, *First Options*' reasoning is consistent with the application of a deferential standard of review to an arbitrator's interpretation of the scope of a submission.

---

14. Of course, the parties in an arbitration can prevent an arbitrator from misinterpreting the scope of their submission by precisely and clearly setting forth the issues to be decided by the arbitrator in a single, comprehensive document or otherwise, something which, of course, MME and TXU Retail failed to do.

In *First Options*, this Court held that a federal court reviews the question of arbitrability *de novo*. *Id.* at 943-45. In doing so, the Court explained:

> Courts should not assume that the parties agreed to arbitrate arbitrability unless there is "clea[r] and unmistakeabl[e] evidence that they did so." *AT&T Technologies*[, *Inc. v. Communications Workers of Am.*], 475 U.S. [643, 649 (1986)]. . . . In this manner the law treats silence or ambiguity about the question of *who* (primarily) should decide arbitrability differently from the way it treats silence or ambiguity about the question *whether* a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement—for in respect to this latter question the law reverses the presumption. See *Mitsubishi Motors*, [473 U.S. at 626]("'Any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration'") (quoting *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *Steelworkers v. Warrior* [&] *Gulf Nav. Co.*, 363 U.S. [574, 582-83 (1960)].
>
> But, this difference in treatment is understandable. The latter question arises when the parties have a contract that provides for arbitration of some issue. In such circumstances, the parties likely gave thought to the scope of arbitration. And, given the law's permissive policies in respect to arbitration, see, *e.g.*, *Mitsubishi Motors*, *supra*, at 626, one can

> understand why the law would insist upon clarity before concluding that the parties did *not* want to arbitrate. . . .

*Id.* at 944-45 (emphasis in original). Of course, a decision regarding the scope of a submission is more akin to the decision of "whether a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement" than it is to the question of arbitrability. Accordingly, an arbitrator's interpretation of the scope of a submission is procedural, not substantive, and the arbitrator necessarily should interpret it in the first instance, with such interpretation being reviewed deferentially by a federal court. *E.g.*, *Pack Concrete, Inc.*, 866 F.2d at 285.

### C. The arbitration record conclusively establishes that MME and TXU Retail submitted the question of the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period to the Panel for determination.

Even if MME's had not waived its issue by failing to raise it in its Third Circuit Brief and even if a federal court reviews an arbitrator's interpretation of the scope of a submission *de novo*, the Petition should still be denied because the arbitration record conclusively establishes that MME and TXU Retail submitted the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period to the Panel for determination. For example:

- TXU Retail in its responses to MME's "Statement of Claims" and in its pre- and post-arbitration briefs consistently maintained that the spot-market gas was sold under a separate course-of-performance contract

and that its spot-market charges during the Disputed Period under that contract were proper. More important, MME never objected to TXU Retail's position or advised the Panel, in response to it, that the only issue in the arbitration was whether the Master Agreement and/or Confirmed Transactions set the spot-market gas price.

- MME agreed, immediately before the arbitration hearing, that there was to be "one final arbitration award" embodying both the settlement of TXU Retail's counterclaims and its recovery on its overcharge claim. Of course, one such award could be issued only if the Panel was empowered to decide if MME was overcharged for spot-market gas during the Disputed Period, irrespective of whether the Master Agreement, the Confirmed Transactions, or the course-of-performance contract set its price.

- TXU Retail introduced expert testimony at the arbitration hearing about the propriety of its spot-market gas charges during the Disputed Period under the course-of-performance contract without objection from MME.

- MME's Pass-Through Claim, raised for the first time during the arbitration hearing, put in issue both the propriety of TXU Retail's spot-market gas charges during the Disputed Period under the course-of-performance contract and whether TXU Retail's spot-market gas charges under that contract during that period reflected the market price.

- The Neutral Arbitrator's Post-Hearing Letter advised the parties that the Panel intended to decide whether the spot-market gas price was the price under the Master Agreement and/or the Confirmed Transactions, as maintained by MME, or the market price under a course-of-performance contract, as maintained by TXU Retail. It also requested information that was relevant only to a determination of the propriety of TXU Retail's spot-market gas charges during the Disputed Period under a course-of-performance contract. And, MME provided the requested information without objection.

- MME despite its knowledge that TXU Retail, at least in its Post-Arbitration Brief, was asking the Panel to determine the propriety of its spot-market gas charges during the Disputed Period under the course-of-performance contract never objected to the request.

- MME participated in post-arbitration award proceedings to determine the amount of TXU Retail's attorneys' fees without objecting to the proceedings as exceeding the Panel's authority because the award was based, as it claimed in the District Court and in the Third Circuit, on the Panel's improper determination that TXU Retail's spot-gas charges during the Disputed Period were reasonable under the course-of-performance contract.

- MME has accepted the benefits of the Panel's determination of the reasonableness of TXU Retail's spot-market gas charges during the Disputed Period. The Panel, after determining that the charges were reasonable under the course-of-performance contract, found more than $174,000 in accounting errors by TXU Retail with respect to them. It, therefore, offset that amount against the stipulated damages MME agreed

> TXU Retail was entitled to recover under its counterclaim. MME, throughout this proceeding, has sought to preserve the offset.

Here, it is clear that MME and TXU Retail unmistakably submitted the question of the reasonableness of TXU Retail's spot-market charges during the Disputed Period to the Panel for determination. This Court should not allow MME to now claim that the Panel exceeded its powers in deciding the submitted issue merely because its determination was unfavorable to MME.

## CONCLUSION

For the foregoing reasons, the Petition should be denied.

Respectfully submitted,

THOMAS F. LILLARD
*Counsel of Record*
ROBERT K. WISE
MILES B. HABERER
HUNTON & WILLIAMS LLP
Energy Plaza
1601 Bryan Street, 30th Floor
Dallas, TX 75201
(214) 979-3000

LEDA DUNN WETTRE
ROBINSON & LIVELLI
Two Penn Plaza East
Newark, NJ 07105
(973) 690-5400

*Attorneys for Respondents*

3

FILED
DEC 14 2005
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 05-295

IN THE

# Supreme Court of the United States

METROMEDIA ENERGY, INC.,

*Petitioner*,

*v.*

ENSERCH ENERGY SERVICES, INC.; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP; TXU JOHN DOES,

*Respondents.*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## REPLY BRIEF FOR PETITIONER

G. ERIC BRUNSTAD, JR.
*Counsel of Record*
RHEBA RUTKOWSKI
SUSAN KIM
BRIAN R. HOLE
BINGHAM MCCUTCHEN LLP
One State Street
Hartford, CT 06103
(860) 240-2717

*Counsel for Petitioner*

## STATEMENT PURSUANT TO RULE 29.6

Petitioner's corporate disclosure statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that statement.

## TABLE OF CONTENTS


| | Page |
|---|---|
| Statement Pursuant to Rule 29.6 | i |
| Table of Contents | ii |
| Table of Authorities | iii |
| I. The Circuits Are Divided Over the Question Presented. | 5 |
| II. The Third Circuit's Decision Conflicts With This Court's Precedents. | 7 |
| III. MME Did Not Waive The Question Presented. | 9 |
| IV. TXU's Factual Contention Regarding The Submission Of The Issues Is Erroneous And Irrelevant. | 10 |
| Conclusion | 10 |

## TABLE OF AUTHORITIES

*Page*

**FEDERAL CASES**

*187 Concourse Associates v. Fishman*, 399 F.3d 524 (2d Cir. 2005) ..... 5

*AT&T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643 (1986) ..... 7

*American Postal Workers v. Runyon*, 185 F.3d 832 (7th Cir. 1999) ..... 5

*Carpenters 46 N. Cal. Counties Conf. Board v. ZCON Builders*, 96 F.3d 410 (9th Cir. 1996) ..... 1

*Coady v. Ashcraft & Gerel*, 223 F.3d 1 (1st Cir. 2000) ..... 1

*Dorado Beach Hotel Corp. v. Union De Trabajadores De La Industria Gastronomica de Puerto Rico*, 959 F.2d 2 (1st Cir. 1992) ..... 5

*Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314 (5th Cir. 1994) ..... 2

*First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) ..... *passim*

*Howsam v. Dean Witter Reynolds*, 537 U.S. 79 (2002) ..... 2, 8

*John Morrell & Co. v. Local Union*, 913 F.2d 544 (8th Cir. 1990) ..... 5

*Madison Hotel v. Hotel & Rest. Emp., Local 25*, 144 F.3d 855 (D.C. Cir. 1998) ..... 1

*Authorities*

*Page*

*Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) ..... 8

*Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960) ..... 7

**FEDERAL STATUTES**

9 U.S.C. § 10(a) ..... *passim*

9 U.S.C. § 11(b) ..... *passim*

## REPLY BRIEF FOR PETITIONER

TXU's Brief in Opposition demonstrates why the Court should grant certiorari in this case. Like several of the courts of appeals, TXU confuses the issue of the *authority* of an arbitrator to decide a particular issue (i.e., the question of "arbitrability," which is reviewed *de novo*) with the *merits* of the arbitrator's decision (i.e., the question whether the arbitrator correctly decided an issue that he or she had the authority to decide, which is reviewed under a deferential standard). Petitioner MME contends, and many courts of appeals have held, that the question of arbitrability (the authority of an arbitrator to decide an issue) turns on two things: (1) whether the issue falls within the scope of the arbitration clause of the parties' pre-negotiated contract; and (2) whether the issue falls within the scope of the parties' submission of the issues for arbitration. In contrast, TXU argues, and several courts of appeals have held, that the scope of the parties' submission is *not* a question of arbitrability and is subject to review under the same deferential standard that governs review of the merits of the arbitrator's award. Opp. at 19-20. Clearly, the scope of the parties' submission either *is* a question of arbitrability subject to independent *de novo* review (as many courts of appeals have held), or is *not* a question of arbitrability and is subject to some other standard of review (as other courts of appeals have held). Certiorari is warranted precisely because the courts of appeals are divided over the question and TXU's contrary analysis of the cases is mistaken. *Compare, e.g., Madison Hotel v. Hotel & Rest. Employees, Local 25*, 144 F.3d 855, 857 n.1 (D.C. Cir. 1998) (distinguishing the scope of the parties' submission from the question of arbitrability and recognizing the different standards of review) *with, e.g, Coady v. Ashcraft & Gerel*, 223 F.3d 1, 8-9 & n.10 (1st Cir. 2000) (reviewing independently under the *de novo* standard as a question of arbitrability both the scope of the pre-negotiated contract and the submission of issues); *Carpenters 46 N. Cal. Counties Conf. Bd. v. ZCON Builders*, 96 F.3d 410, 415-16 (9th Cir. 1996) (concluding that "the district court erred in deferring to the arbitrator's decision" regarding arbitrability, including whether a party

by its conduct had agreed to submit a particular question to the arbitrator); *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1321, 1323 (5th Cir. 1994) (addressing whether an "issue was arbitrable"; stating that "[i]f the parties go beyond their promise to arbitrate and actually submit an issue to the arbitrator, we look both to the contract and to the scope of the submissions to the arbitrator to determine the arbitrator's authority," and concluding "that the question of whether a party can be compelled to arbitrate, as well as the question of what issues a party can be compelled to arbitrate, is an issue for the court rather than the arbitrator to decide").

Certiorari also is warranted because the decision of the Third Circuit conflicts with prior decisions of this Court. Arguing to the contrary, TXU contends once again that the scope of the parties' submission is not a question of arbitrability and, therefore, that the Court's precedents applying a *de novo* standard of review to questions of arbitrability do not apply. As this Court has explained, however, "[t]he question whether the parties have submitted a particular dispute to arbitration, i.e., the *question of arbitrability*, is an issue for judicial determination." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002) (internal quotation marks and citations omitted). Because the scope of the parties' submission *is* a question of arbitrability, no less than the scope of their pre-negotiated contract, it is properly subject to *de novo* review.

Further, although TXU contends that MME waived its presentation of the question presented, this assertion is indefensible. The relevant portions of MME's brief to the Third Circuit refuting TXU's contention are recited below. More important, the Third Circuit plainly understood that MME was challenging the arbitrator's authority, stating: "MME's challenge to the arbitration award focuses not upon the underlying merits of the panel's analysis, but rather upon whether the panel exceeded its authority by resolving in its opinion an issue the parties had not agreed to arbitrate." Pet. App. at 8a. At MME's urging, the district court reviewed the record independently and *expressly found* that "the record in this matter does not support TXU's contention that MME and

TXU submitted to the arbitrators issues regarding the terms of the spot gas contract and whether TXU's pricing pursuant to the spot gas contract was reasonable." Pet. App. at 26a. In its brief to the Third Circuit, MME plainly urged the court to affirm the district court's approach and conclusions, and stated that the Third Circuit should review the district court's determination under the ordinary standard of appellate review required by this Court's decision in *First Options* (i.e., findings of fact are set aside only if they are clearly erroneous, and conclusions of law are reviewed *de novo*). But instead of doing so, the Third Circuit stated: "[W]e owe no deference to the District Court's analysis, and instead we exercise plenary review over the District Court's decision to vacate the arbitration award." Pet. App. at 9a. The Third Circuit then rejected the district court's independent *de novo* approach and instead followed its prior precedents in *Matteson* and *Roadway* requiring broad deference to the arbitrator's decision. Pet. App. at 8a-11a. Contrary to TXU's argument, the Third Circuit's rejection of both the district court's *de novo* approach and MME's arguments in favor of that approach does not demonstrate waiver. Rather, it demonstrates precisely the opposite – that the Third Circuit squarely resolved the question presented by rejecting MME's arguments.

Moreover, TXU does not deny that the question presented is an important issue that implicates the legitimacy of arbitration proceedings. Nor does TXU deny that the resolution of the question presented in this case is outcome determinative. Applying an independent *de novo* standard of review on the question of arbitrability, the district court overturned the arbitrators' award as straying beyond the scope of their authority. Applying a highly deferential standard of review, the Third Circuit ordered affirmance of the arbitrators' award as within their authority, based on deference to the arbitrators' implicit determination that the controversy was arbitrable. The Third Circuit did *not* contend that the district court erred in its application of its independent *de novo* standard. Nor did the Third Circuit contend that the district court's factual findings were clearly erroneous. Rather, the Third Circuit simply rejected in its entirety the district court's

*de novo* approach in favor of a highly deferential standard. The issue is thus properly presented in this case, and it is one that the Court should review.

TXU contends that the question that the arbitrators ultimately decided (e.g., the reasonableness of TXU's charges under the separate "course-of-performance" contract) was, in fact, "submitted" to the arbitrators because TXU presented arguments during the course of the arbitration proceeding regarding the reasonableness of its prices under this separate "contract." But TXU does not challenge as clearly erroneous the district court's contrary factual finding that MME never agreed that the arbitrators could decide this issue. *See* Pet. App. at 27a ("After reviewing the record, the Court is satisfied that at no time did MME consent to have the panel determine what terms and conditions were applicable to the spot gas contract if the Master Agreement did not apply to the spot gas sales."). Moreover, as this Court's analysis in *First Options* suggests, the mere fact that one party makes arguments about an issue during an arbitration proceeding does not demonstrate that *both* parties thereby agreed for the issue to be submitted to the arbitrators as is required for the arbitrators to have the necessary authority to decide it. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 946 (1995) ("[M]erely arguing the arbitrability issue to an arbitrator does not indicate a clear willingness to arbitrate that issue"). Indeed, TXU concedes that, following the parties' partial settlement of their claims and counterclaims just prior to the arbitration hearing (which settlement encompassed *all* of TXU's counterclaims), the only claim that remained for the arbitrators to decide was MME's claim that TXU overcharged MME in violation of the *Master Agreement*. Opp. at 6-7. Although TXU could (and did) present arguments suggesting that the Master Agreement was not violated because the terms of the Master Agreement did not apply to the particular spot transactions in question, TXU did not thereby bind MME to arbitrate the reasonableness of TXU's prices under any separate course-of-performance contract because, under the terms of the arbitration clause of the Master Agreement, MME agreed contractually to arbitrate only disputes under the *Master Agreement*, not other contracts, and

MME never consented to the submission of any other issue. MME was entitled to rely on the limited scope of the arbitration proceeding, as defined by the Master Agreement and MME's single remaining properly submitted claim, and TXU was not entitled to expand unilaterally the arbitrator's jurisdiction. In any event, TXU's argument supplies no basis to deny certiorari review because, owing to its decision to defer to the arbitrators' implicit determination of arbitrability, the Third Circuit never actually considered whether any of the district court's factual determinations were clearly erroneous, including the district court's independent factual finding that MME never consented to submit to the arbitrators the question whether the spot gas transactions were reasonable. To the extent that TXU wishes to challenge the district court's findings, it may do so on remand in accordance with ordinary appellate procedures under a correct standard of review.

## I. The Circuits Are Divided Over the Question Presented.

As explained in MME's Petition, many courts of appeals have held that an arbitrator's authority over a particular issue (i.e., the arbitrability of the issue) turns on consideration of two things: (1) the terms of the parties' pre-negotiated contractual arbitration clause; and (2) the terms of their submission of the issues for arbitration. *See, e.g., 187 Concourse Associates v. Fishman*, 399 F.3d 524, 527 (2d Cir. 2005) ("[T]he scope of authority of arbitrators generally depends on the intention of the parties to an arbitration, and is determined by the agreement or submission") (internal quotation marks and citation omitted); *American Postal Workers v. Runyon*, 185 F.3d 832, 835 (7th Cir. 1999) ("The parties may limit the arbitrator's contractual authority to address a dispute through: (1) the contract; and (2) the issue submitted to the arbitrator."); *Dorado Beach Hotel Corp. v. Union De Trabajadores De La Industria Gastronomica de Puerto Rico*, 959 F.2d 2, 4 (1st Cir. 1992) ("[A]n arbitrator's authority [under the parties' contract] may be supplemented by the parties' submissions."); *John Morrell & Co. v. Local Union*, 913 F.2d 544, 561 (8th Cir. 1990) ("[W]e must look both to their contract and to the submission of the issue to the arbitrator to determine his authority.") (emphasis, internal quotation marks, and citation omitted). Thus, even

though a pre-negotiated contract may provide for the arbitration of certain issues, the parties may limit or expand the scope of the proceeding by agreeing to submit a particular set of issues for arbitration. In this way, the parties establish by agreement (either through their pre-negotiated contract or their submissions) the arbitral jurisdiction of the arbitrators. Under the express provisions of sections 10(a) and 11(b) of the FAA, a federal district court is authorized to ensure that an arbitrator stays within the bounds of his or her arbitral jurisdiction by vacating or modifying an arbitration award "[w]here the arbitrators exceeded their powers" or "[w]here the arbitrators have awarded upon a matter not submitted to them." 9 U.S.C. §§ 10(a) & 11(b).

Contrary to the decisions of the courts of appeals cited above, TXU asserts that the question of the scope of the parties' submission is *not* a question of arbitrability. Building on this premise, TXU separates "the standard of review of an arbitrator's determination of arbitrability – whether the parties have agreed to arbitrate in the first instance – and the standard of review of an arbitrator's interpretation of the scope of the submission." Opp. at 18. TXU *concedes* that the proper standard of review applicable to the question of arbitrability is *de novo*. Opp. at 25. Nevertheless, TXU asserts that the question of the authority of an arbitrator to decide an issue based on the scope of the parties' submission should be reviewed in the same manner as the merits of the arbitrator's decision – under a highly deferential standard – citing circuit decisions in support of its position. Opp. at 19. But inasmuch as the scope of the parties' submission defines the arbitrator's authority no less than the scope of the parties' pre-negotiated contract (as many courts of appeals have held), the scope of the parties' submission plainly *is* a question of arbitrability and TXU's distinction is a false dichotomy. More important, far from demonstrating the absence of a circuit conflict, TXU's argument and supporting citations prove the existence of a sharp conflict among the circuits, as the decisions cited by TXU conflict squarely with all of the circuit decisions that hold that the question of the scope of the parties' submission defines

the authority of the arbitrators no less than the parties' pre-negotiated contract.

It is telling that neither TXU nor any of the cases upon which it relies offers any explanation why review of the scope of the parties' submission should be treated any differently from review of the arbitrator's interpretation of the scope of the arbitration clause in the parties' pre-negotiated contract. Because both define the scope of the arbitrator's authority and are for the court to decide under sections 10(a) and 11(b) of the FAA, both are questions of arbitrability subject to *de novo* review. And because numerous courts of appeals have made the same mistake that TXU makes in this case (by conflating the authority of the arbitrator to make a decision with the merits of a decision that the arbitrator has the authority to make), certiorari is warranted to address and resolve the profound confusion and conflict among the circuits on this important question of law.

## II. The Third Circuit's Decision Conflicts With This Court's Precedents.

The decision below conflicts with the decisions of this Court establishing that the question of arbitrability is for the court to decide under a *de novo* standard. In response, TXU contends once again that the question whether the arbitrators exceeded their authority by straying beyond the scope of the issue submitted is not a question of arbitrability and, therefore, that the Court's decision in *First Options* does not apply. Opp. at 24. TXU's analysis is wrong because the question whether the arbitrators exceeded their authority by straying beyond the scope of the issue submitted *is* a question of arbitrability, no less than the question whether the arbitrators exceeded their authority by straying beyond the scope of the parties' pre-negotiated arbitration clause, as both define the arbitral jurisdiction of the arbitrators.

As the Court stated in *AT&T*, "'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *AT&T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648 (1986) (quoting *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)). The rule that follows

"inexorably" from this basic principle "is that the question of arbitrability . . . is undeniably an issue for judicial determination." *Id.* at 649. Furthermore,

> [a]lthough the Court has also long recognized and enforced a "liberal federal policy favoring arbitration agreements," . . . it has made clear that there is an exception to this policy: The question whether the parties have submitted a particular dispute to arbitration, i.e., the *"question of arbitrability,"* is "an issue for judicial determination unless the parties clearly and unmistakably provide otherwise."

*Howsam*, 537 U.S. at 83 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *AT&T*, 475 U.S. at 649; *First Options*, 514 U.S. at 944).

In support of its contrary argument, TXU quotes extensively from the Court's analysis in *First Options*, addressing whether parties may agree to submit *the question of arbitrability itself* to the arbitrators. Opp. at 25-26. That issue, however, is not implicated in this case because no party has ever claimed – and certainly there is no "clear and unmistakable evidence" – that MME and TXU ever intended the arbitrators to decide the question of arbitrability. TXU, of course, does not contend otherwise. Instead, TXU simply quotes the Court's discussion on this issue in *First Options* and then adds the bewildering statement that "a decision regarding the scope of a submission is more akin to the decision of 'whether a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement' than it is to the question of arbitrability." Opp. at 26. This statement, however, simply demonstrates TXU's confusion (shared by several courts of appeals). The question whether the parties actually submitted an issue to an arbitrator for decision defines whether the parties intended the arbitrator to decide the issue just as much as the question whether the parties' arbitration clause in their pre-negotiated contract requires the issue to be submitted to arbitration. Both address "who" should decide the issue because, under sections 10(a) and 11(b) of the FAA, the district court may vacate or correct

an award to the extent that it involves the determination of a question that has not been submitted.

**III. MME Did Not Waive The Question Presented.**

TXU is similarly mistaken in asserting that MME waived the question presented by not arguing it below. To begin with, MME argued to the Third Circuit that "[i]n evaluating the scope of an arbitrator's authority, this Court evaluates both the parties' agreement to arbitrate and the submissions to the arbitrator." MME's Third Circuit Brief at 24. Indeed, as noted in MME's brief at pages 24-25 note 7, TXU's counsel conceded this very point in the district court:

> THE COURT: The scope of the arbitrator's authority is determined by looking both at the arbitration agreement and its scope and the scope of the submission. Correct?
>
> MR. HABERER: That's correct.

Appendix of the Record in the Third Circuit, at A813-814.

In its statement of the relevant standard of review, MME pointed out that, in conducting its independent review, the district court made several findings of fact, including that "the record in this matter does not support TXU's contention that MME and TXU submitted to the arbitrators issues regarding the terms of the spot gas contract and whether TXU's pricing pursuant to the spot gas contract was reasonable." MME's Brief at 16-17. MME argued that these findings were not clearly erroneous and, thus, "must stand." *Id.* at 17. MME argued further that, in conducting its own independent review in the context of a motion to vacate an arbitration award on the ground that the arbitrators strayed beyond their authority, "the district court ruling on a motion to vacate may make its own factual findings regarding the reasons for which the motion should be denied or granted, and such findings are reviewed for clear error." MME's Brief at 16. In addition, MME argued: "Under the FAA, the standard to be applied by an appellate court in reviewing the district court's decision either vacating or upholding an award is the ordinary standard in any appellate review of a lower court decision finding an agreement between the parties: findings of fact are reviewed

under the clearly erroneous standard while questions of law are reviewed *de novo*." MME's Brief at 16 (citing *First Options*).

MME clearly asserted its argument in the Third Circuit. More important, the Third Circuit plainly considered and rejected the district court's independent approach, together with MME's arguments in support of that approach. TXU's waiver argument is baseless, and the record demonstrates that the Third Circuit squarely resolved the question presented by rejecting MME's arguments.

## IV. TXU's Factual Contention Regarding The Submission Of The Issues Is Erroneous And Irrelevant.

Finally, TXU opposes MME's Petition by challenging the district court's factual determination that MME never agreed to submit the issue of the reasonableness of TXU's spot gas sales. As noted, the Third Circuit never addressed this issue because it set aside the district court's analysis in its entirety. Moreover, as noted, the mere fact that TXU presented arguments on the issue did not bind MME to "submit" the issue for arbitration. In any event, inasmuch as the Third Circuit did not address TXU's factual challenge, TXU's contention provides no basis to deny certiorari review of the question presented. If TXU wishes to pursue its factual challenge, it may do so on remand under a correct standard of review.

## CONCLUSION

For the foregoing reasons and the reasons set forth in MME's Petition, the Court should grant certiorari in this case.

Respectfully submitted,

G. Eric Brunstad, Jr.
*Counsel of Record*
Rheba Rutkowski
Susan Kim
Brian R. Hole
Bingham McCutchen LLP
One State Street
Hartford, CT 06103
(860) 240-2717

*Counsel for Petitioner*

Dated: December 14, 2005